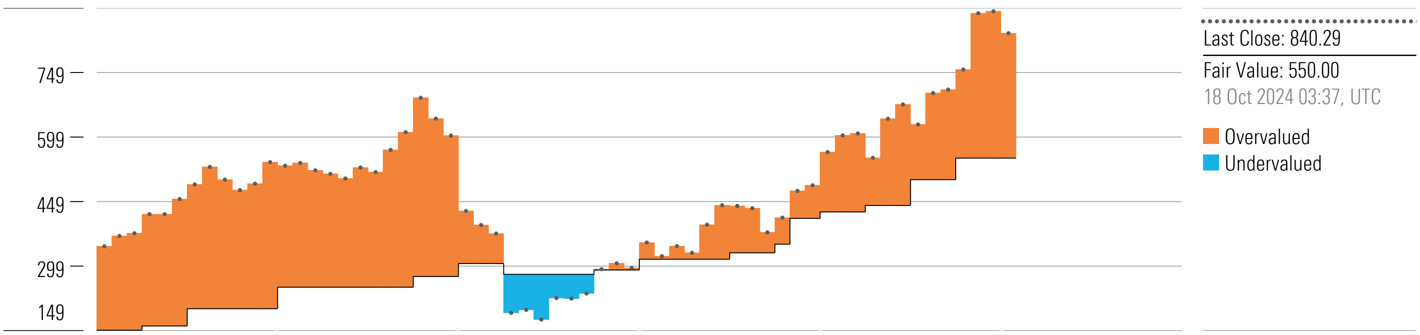
Morningstar Equity Analyst Report | Report as of 14 Jan 2025 23:54, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

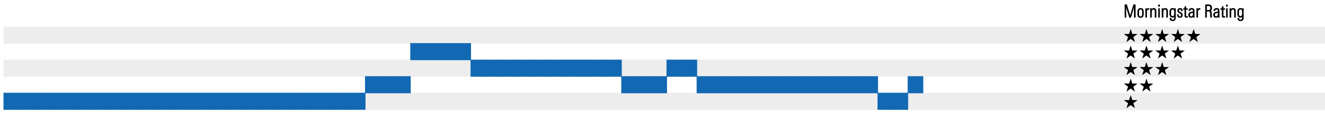
Netflix Inc NFLX ★★ 14 Jan 2025 22:30, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
840.29 USD 13 Jan 2025	550.00 USD 18 Oct 2024 03:37, UTC	1.53	354.11 USD Bil 14 Jan 2025	Narrow	Large Growth	High	Exemplary	1 Jan 2025 06:00, UTC

Price vs. Fair Value



	2020	2021	2022	2023	2024	YTD
Price/Fair Value	2.70	2.19	1.02	1.19	1.62	1.53
Total Return %	67.11	11.41	-51.05	65.11	83.07	-5.73



Total Return % as of 13 Jan 2025. Last Close as of 13 Jan 2025. Fair Value as of 18 Oct 2024 03:37, UTC.

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

[1]The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

Subscriber Growth Should Slow, but Netflix Has Other Levers to Keep Sales and Profit Growth High

Business Strategy & Outlook Matthew Dolgin, CFA, Senior Equity Analyst, 19 Jul 2024

Netflix is the leading streaming television platform globally and now enjoys the economic benefits of market-leading scale. We expect this position will persist throughout the next decade.

Netflix has had a different strategy than its peers. It has avoided the temptation to offer wide-scale live sports programming, which has been wise, considering our view that it would've had to overpay to attract major sports leagues. It has also chosen to grow organically from the ground up, building its business with no head start in terms of content ownership or foothold in the traditional media business. These decisions now give Netflix the advantage of not having to manage a declining legacy business, and it isn't burdened with expensive sports contracts or a subscriber base that is dependent on retaining sports rights.

Netflix does face threats. The traditional television business is now well into its evolution, as streaming offerings have become foremost priorities for nearly all media companies. Netflix entered the streaming market well before any major competitors, and it charged an almost nominal price, making it an easy choice for many consumers. With many options now, we don't believe consumers will have the financial willingness or ability to subscribe to all, meaning Netflix will need to continue generating a broad array of attractive content to maintain its position. Also, with competitors now less willing to license their

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Sector	Industry
Communication Services	Entertainment

Business Description

Netflix's relatively simple business model involves only one business, its streaming service. It has the biggest television entertainment subscriber base in both the United States and the collective international market, with more than 280 million subscribers globally. Netflix has exposure to nearly the entire global population outside of China. The firm has traditionally avoided live programming or sports content, instead focusing on on-demand access to episodic television, movies, and documentaries. The firm recently began introducing ad-supported subscription plans, giving the firm exposure to the advertising market in addition to the subscription fees that have historically accounted for nearly all its revenue.

content to third parties, it is now critical that Netflix continues to be successful with the content it creates.

Still, we expect Netflix to remain the industry's leader. Assuming no huge misfires that result in a lack of attractive programming over an extended period, we expect Netflix's subscriber base to be sticky, and we think the cash it generates will allow it the capacity to produce many new series and movies each year, giving ample opportunity for customers to find something they like. We see further penetration opportunity in international markets, and we believe the introduction of an ad-supported subscription in the US will provide opportunities to reach new subscribers and bring a new source of revenue that could be substantial.

Bulls Say Matthew Dolgin, CFA, Senior Equity Analyst, 18 Oct 2024

- Netflix has already created many hit shows that are exclusively available on its platform and have attracted a massive customer base. The firm's advantage in cash generation versus competitors makes it more likely this virtuous cycle can continue, with Netflix creating more content that attracts and holds its subscribers.
- Advertising-supported subscriptions will open Netflix to a new base of subscribers and a potentially substantial new source of revenue.
- Netflix has significant room to grow in international markets where it has already shown promise with local content.

Bears Say Matthew Dolgin, CFA, Senior Equity Analyst, 18 Oct 2024

- Netflix is beginning to face competition that it has not had to deal with in the past. As consumers have more options for quality streaming services, it's more likely that Netflix could get cut out of some consumer budgets.
- Netflix's US business is mature, with very high penetration of total households, meaning price increases may need to be a bigger component of future growth.
- Creating attractive content is always a gamble, meaning the allure of Netflix's service will always be tenuous and dependent on the firm continually producing hits.

Economic Moat Matthew Dolgin, CFA, Senior Equity Analyst, 19 Jul 2024

We assign Netflix a narrow moat rating based on intangible assets and a network effect. Netflix has two advantages that set it apart from streaming-video peers. First, it has no legacy assets that are losing value as society transitions to new ways of consuming video entertainment at home, allowing it to put its full effort behind its core streaming offering. Second, it was the pioneer in its industry, providing it a big head start in accumulating subscribers and moving past the huge initial cash burn that we see as necessary to build a successful streaming service. This subscriber base was critical in creating a virtuous cycle for Netflix that we doubt can be breached by more than a small number of competitors, which is what we think would be necessary to dampen Netflix's ability to earn excess economic returns for the

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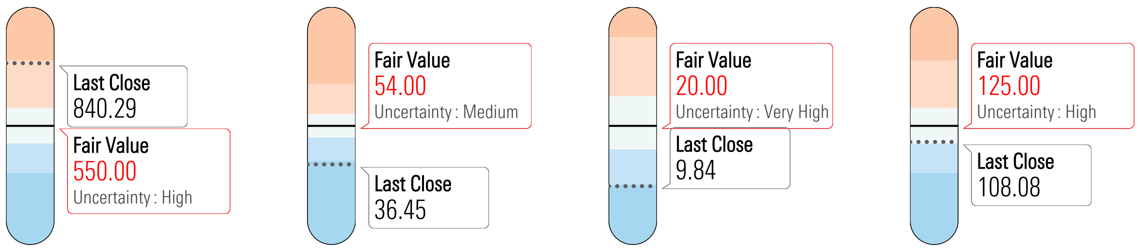
Competitors



	Netflix Inc NFLX	Comcast Corp Class A CMCSA	Warner Bros. D...ares - Class A WBD	The Walt Disney Co DIS
Economic Moat	Narrow	Narrow	None	Wide
Currency	USD	USD	USD	USD
Fair Value	550.00 18 Oct 2024 03:37, UTC	54.00 23 Jul 2024 18:10, UTC	20.00 10 Dec 2024 03:40, UTC	125.00 14 Nov 2024 19:41, UTC
1-Star Price	852.50	72.90	35.00	193.75
5-Star Price	330.00	37.80	10.00	75.00
Assessment	Overvalued 14 Jan 2025	Undervalued 14 Jan 2025	Undervalued 14 Jan 2025	Fairly Valued 14 Jan 2025
Morningstar Rating	★★14 Jan 2025 22:30, UTC	★★★★14 Jan 2025 22:32, UTC	★★★★14 Jan 2025 22:30, UTC	★★★14 Jan 2025 22:31, UTC
Analyst	Matthew Dolgin, Senior Equity Analyst	Michael Hodel, Director	Matthew Dolgin, Senior Equity Analyst	Matthew Dolgin, Senior Equity Analyst
Capital Allocation	Exemplary	Standard	Standard	Standard
Price/Fair Value	1.53	0.67	0.49	0.86
Price/Sales	9.85	1.17	0.61	2.17
Price/Book	15.81	1.63	0.69	1.94
Price/Earning	47.50	9.74	—	25.46
Dividend Yield	0.00%	3.40%	0.00%	0.88%
Market Cap	354.11 Bil	139.21 Bil	23.87 Bil	195.80 Bil
52-Week Range	475.26—941.75	36.15—45.82	6.64—12.70	83.91—123.74
Investment Style	Large Growth	Large Value	Mid Value	Large Value

foreseeable future.

Ultimately, having a successful streaming service is all about offering customers a continuing depth of appealing content at a price point that consumers deem reasonable. The streaming industry is not necessarily a zero-sum game, as customers can always add incremental subscriptions, but consumer budgets are finite, so practically we expect only a handful of streaming services to consistently hold very large customer bases, which we think will be necessary to continue funding content investments.

Securing content requires either tens of billions of dollars of cash every year or, to a lesser extent, existing ownership of content that is enduring and can continue to attract subscribers. With access to enough cash, any enterprise could compete for the best content, but it takes a continuing stream of cash for a provider to have the best odds of having attractive content at any given time. We assume that any rational competitor will eventually require sufficient revenue streams from its operations to continue funding content creation at scale.

Netflix had the luxury of overcoming its cash burn—and achieving excess economic returns—during a time when few competitors kept it from expanding its subscriber base and achieving the scale that is critical for success. More recent and future competitors must attempt to reach scale while offering a compelling alternative to numerous other streaming choices. Before they're earning much revenue, they'll have to undertake the same or higher marketing and platform expenses Netflix had, but they'll also need premier, first-run content—which wasn't the case when Netflix began—requiring higher content spending. They'll also be doing this while competing with Netflix.

Netflix now has the biggest subscriber base, by a wide margin relative to any competitor in the US and internationally. The subscriber base that Netflix began accumulating before competitors entered is the firm's most important intangible asset, and we believe that base has created a network effect that continues to make the platform stickier for all customers. Cash generated from Netflix subscribers gave the company the means to create its own production studio and spend more on entertainment content than any streaming peer. Programming choices have yielded many very popular hits, which have then drawn even more subscribers. The additional subscribers have further increased profits, allowing an additional portion to go toward incrementally more content spending, allowing Netflix to attract premier talent and take many shots at creating hits. This is the virtuous cycle.

In addition, the eyeballs Netflix has attracted and inertia among customers seemingly results in some shows becoming hits in large part because they're on the Netflix platform. We believe many consumers go to Netflix to determine what they want to watch rather than go to Netflix as the destination for what they're already looking to watch. A television show like Suits, which originally aired a decade ago on the USA network with relatively modest success, became a huge hit in 2023 after Netflix began marketing it on its platform. Similarly, we suspect many sports documentaries, including Formula1: Drive to Survive, that track sports that are less mainstream and don't have large existing fan bases, become hits largely because they're on Netflix. We believe this is another aspect of the Netflix platform that creates an advantage in both drawing talent and making customers reticent to cancel a Netflix. While any given movie or television show has the potential to be a bust, the ability for Netflix to continue funding a large menu of options makes us think this is unlikely the firm has an extended dry run without any attractive new options for subscribers.

Fair Value and Profit Drivers Matthew Dolgin, CFA, Senior Equity Analyst, 18 Oct 2024

We're raising our fair value estimate for Netflix to $550 from $500, implying a multiple of 23 times on our 2025 earnings per share forecast. We project high-single-digit average annual revenue growth over our five-year forecast, and we believe there's room for margin expansion, as international markets mature and benefit from greater scale.

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We expect subscriber growth to come mostly from international markets over the long term. After a jump in household penetration that began in 2023, which we attribute to the crackdown on password sharing and ad-supported subscription alternatives, we expect new member growth in the US and Canada (UCAN) to slow significantly in 2025. Over our forecast, we project UCAN member growth of about 2% annually, only marginally exceeding the rate we expect for household formation. We project UCAN average revenue per member, or ARM, to rise at a mid-single-digit rate each year. We expect the firm to continue raising prices at least every two years, but we also expect a material bump from advertising revenue. Netflix began selling ad-supported subscriptions in 2022, but it has not yet reached its potential on selling ads within that service, leaving room for upside.

Penetration rates in Europe, the Middle East, and Africa (EMEA), Latin America, and Asia Pacific (APAC) significantly trail those in the US, so we expect much more room for subscriber growth. As Netflix continues to create more country-specific content and find the right pricing strategy, we believe penetration can go higher, though we don’t expect most countries to get close to the penetration rates in UCAN. We believe subscriber growth in APAC can grow at a low-double-digit rate throughout our forecast, driven by growth in India, while we project Latin America and EMEA subscriber bases to grow in the mid-single-digits annually. We don’t expect ARM growth to be as strong, mostly due to a greater mix from countries that feature lower pricing, but we still project a low-single-digit annual rate as subscription prices rise and advertising revenue takes hold.

Netflix’s biggest cost is content spending. With the actors’ and writers’ strikes limiting production in 2023, content spending fell to $12.5 billion, but we project it to jump to $17 billion in 2024, consistent with management’s target. From there, we believe the firm will look to allocate incremental capital to content at a rate that takes into account the firm’s ability to grow revenue. Considering our outlook for sales growth, we therefore project content spending to grow at about 7% annually. Content amortization, which is the figure reflected in the income statement, should grow at a similar rate. However, we believe there will be operating leverage on other costs, resulting in operating margins rising from 21% in 2023 to almost 30% by 2028.

The production shutdowns in 2023 resulted in a big jump in free cash flow—to nearly $7 billion—but we expect it to drop by $500 million-$1 billion in 2024. After that, we expect cash flow to continue climbing as the business matures in more markets. We project a gradual rise to over $12 billion in free cash flow by 2028.

Risk and Uncertainty Matthew Dolgin, CFA, Senior Equity Analyst, 30 Nov 2023

Our Morningstar Uncertainty Rating for Netflix is High. Our rating is largely based upon the evolving streaming media landscape and the additional competition Netflix now faces.

In our view, Netflix’s tremendous success is due, in large part, to it being a first mover in the streaming industry and successfully adapting its business model to where the industry was going, while its media peers were largely still focusing on their legacy businesses.

The landscape has now changed, as nearly every major media company is promoting its own stand-alone streaming service. Also, Netflix is more focused on profitability and cash generation that it was in its infancy, meaning prices for consumers have risen substantially over the past several years. Customers now have other choices for streaming subscriptions and the price they pay for Netflix is no longer an afterthought, creating uncertainty around Netflix's ability to attract and retain customers. As the streaming businesses of competitors mature, they may bundle their services together—with or without Netflix—or they may offer their services as add-ons for pay-TV subscribers who receive their linear channels, a foothold Netflix doesn't currently have. These factors make it possible that Netflix will have a tougher time growing its subscriber base or generating as much revenue per subscriber.

Other factors that bring greater uncertainty include the firm's nascent ad-supported service, which will require the firm to successfully build out advertising capabilities, and the shift to creating its own content to a greater extent, as content owners have become more reticent in licensing programming to third parties.

From an ESG perspective, we believe potential social issues could carry the greatest risk. The entertainment industry in general has a history of bad behavior regarding issues like sexual assault and harassment and racial and gender discrimination.

Capital Allocation Matthew Dolgin, CFA, Senior Equity Analyst, 18 Oct 2024

We assign Netflix an Exemplary Morningstar Capital Allocation Rating. Our rating is based on our assessment of Netflix's ability to add value through investments in its business and takes into account how the company has managed its balance sheet and capital return policies.

Management had the foresight to see that the success it found in the DVD-by-mail subscription business would be fleeting, as technology and video consumption evolved, and it was willing to go all in to move to an entirely different business model. At a time when capital was cheap and equity investors were very willing to fund money-losing enterprises with hopes of a future payoff, Netflix management took advantage. With a prudent mixture of equity and low-interest-rate debt, Netflix transitioned its business, funding it through years of negative cash flow to build an industry-leading streaming customer base, expand to numerous international markets, and rev up its production capabilities for original content.

But even while cash losses were acceptable and the foremost priority was luring streaming subscribers, we commend management for the judicious decisions it made regarding where to best allocate capital. Notably, we think it has been smart to stay out of the race for live sports programming. Bidding obscene amounts for sports rights would have certainly cemented Netflix's place on the media map and drawn subscribers, but we think it would've damped potential profitability. Similarly, the firm has avoided any splashy acquisitions that could have accelerated its standing as a top media player but may have gotten the firm into businesses that will be less lucrative in the future than the past. Instead, Netflix built its streaming business gradually and organically while ultimately sunsetting the DVD-by-mail business.

The choices Netflix made have paid off. Apart from having the most ubiquitous streaming platform, the firm is far ahead of peers in its ability to generate significant cash through the streaming business model. Management has now shifted to becoming more prudent regarding cash generation and spending while still striking a balance and allocating large amounts of capital to procuring new content each year.

We expect the maturing business to allow for improved financial footing from here, but Netflix already stands in good financial shape. At the end of September 2024, the firm had $9 billion in cash versus $16 billion in debt and was poised to generate over $6 billion in free cash flow for the full year, a level we expect will continue growing. The firm should no longer need to raise additional capital as it deepens its subscriber base in international markets and continues creating and licensing content.

Wisely, Netflix has never paid a dividend, but with the firm now being a significant cash generator, it has had a share repurchase program in place since 2021. We believe management will regularly return capital to shareholders via the buyback as long as it doesn’t see significant, compelling opportunities outside what has become its normal course of operations.

Analyst Notes Archive

Netflix Earnings: Signs of Subscriber Growth Normalization, but Sales and Margins Remain Impressive Matthew Dolgin, CFA,Senior Equity Analyst,18 Oct 2024

Netflix’s very strong third-quarter sales growth was largely assured, considering the huge increase in subscribers over the past few quarters. Still, we were impressed at how much further margins expanded beyond the huge rise already this year. Netflix also offered an initial sales and margin outlook for 2025 that portends less of a deceleration than we anticipated following a blockbuster 2024. The third quarter showed the slowdown in subscriber growth that we’ve been expecting, but Netflix has other areas of opportunity to continue boosting its financial performance.After adjusting our projections, we’re raising our fair value estimate to $550 from $500. Still, while the firm’s persistent near-term strength exceeds our expectations, and we expect Netflix to remain well ahead of competitors, we think the market is extrapolating recent amazing results too far into the future. We think some markets are approaching saturation, and although we see opportunities for Netflix to enhance revenue per subscriber, we don’t think those are so big as to offset decelerating subscriber additions. We also expect much more moderate margin expansion than has occurred in 2024 because we expect Netflix will increase content spending at a similar rate as sales to help maintain its wide lead over competitors and strengthen its moat, which we rate as narrow today.Third-quarter sales grew 15% year over year, and the firm added another 5 million subscribers globally, including about 700,000 in the United States and Canada. While solid, both figures were the fewest since the first quarter of 2023, and we think they now put Netflix on more of a normalized pace after the firm added about 40 million global subscribers and 9 million UCAN subscribers over the prior four quarters. We expect greater advertising monetization and price increases to contribute more to growth over time, but in the third quarter, average revenue per subscriber was flat globally.

Netflix Earnings: Another Exquisite Quarter, Almost Nothing to Nitpick; Fair Value Up 14% to $500

Matthew Dolgin, CFA,Senior Equity Analyst,19 Jul 2024

Narrow-moat Netflix reported another outstanding quarter despite diminishing tailwinds from the crackdown on password sharing and the introduction of ad-supported plans. Revenue growth accelerated, and subscriber additions and margins remained at historically high levels. We still believe that recent results represent an especially booming period rather than a durable new norm. However, the firm's current momentum has proven longer lasting than we originally anticipated. We are raising our fair value estimate to $500 per share from $440. We believe the stock is pricing in a continuation of recent trends, and while we maintain that Netflix is best-in-class, we still expect the firm to experience slower periods, making the shares overvalued.Second-quarter sales rose 17% year over year, the best quarterly result since 2021, but this likely represents a peak for growth. The company has now lapped its broader crackdown on password sharing, which we believe is largely responsible for the spike in subscriber additions that began in the middle of 2023 and has continued. Netflix increased its subscriber base by another 8 million members during the second quarter, including by 1.5 million in the US, and it has expanded its subscriber base by nearly 17%, or almost 40 million members, over the past year. Netflix has still not yet cracked down on password sharing across its entire membership base, which is one reason we now expect a longer tail of elevated subscriber additions. Still, we think the biggest boost from a perfect storm of catalysts has now passed, especially in the US.We expect growth in average revenue per member, which has been flat over the past year, to play a bigger role in sales growth in the long term. ARM increased 7% year over year in the US for the second straight quarter, but ARM declined in all other regions due mostly to a combination of currency weakness and a mix shift to lower-priced markets, like India.

Netflix: First Step Into Major Sports With Christmas NFL Games Isn’t a Needle Mover but Shows Power

Matthew Dolgin, CFA,Senior Equity Analyst,15 May 2024

The National Football League's announcement that Netflix will be the exclusive home for a total of at least four NFL games over the next three Christmases doesn't affect our $440 fair value estimate. We don't expect significant subscriber benefits from these games, and The Wall Street Journal reported Netflix will pay about $75 million per game, which is not substantial in the context of the firm's annual content spending. However, the NFL's decision to partner with Netflix and highlight the global nature of

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the streaming rights hints at the value of Netflix's platform and its unparalleled global reach.Unlike limited sports rights on other streaming platforms, such as Amazon Prime with a weekly Thursday NFL game, Netflix will have rights for only one day per year under this deal. While Netflix may see an uptick in subscriber additions in advance of each year's NFL games, we doubt a substantial number are unfamiliar with what Netflix offers and will decide to become long-term subscribers. We simply don't think Netflix needs the exposure that a one-off sporting event will bring. Netflix will undoubtedly see an influx of advertising revenue on game days, but we suspect benefits from the modest bump in revenue will be offset by the cost of these rights.We'd have mixed feelings if Netflix, as is often rumored, made a bigger shift in its historical strategy of avoiding major live sports. We don't think Netflix needs the consumer exposure that sports bring, though such a move would likely bring some incremental subscribers. Although we don't think it's currently necessary, adding a few key events could also ensure Netflix's long-term place in a service bundle, like that rumored to be forming between it, Peacock, and Apple TV+. However, we believe Netflix should avoid going down a path that could put it in a similar position as the legacy media companies, where it feels compelled to retain sports rights with costs that become an outsize portion of its content budget.

Netflix Earnings: Fantastic Period Dampened by Likelihood of Growth Deceleration Matthew Dolgin, CFA,Senior Equity Analyst,19 Apr 2024

Netflix reported another quarter of incredible subscriber additions and revenue and profit growth. However, full-year sales guidance portends a deceleration in the second half, and the firm’s decision to stop regularly reporting subscriber numbers in 2025 supports our belief that yearly subscriber additions will reset at a significantly lower level. With the stock selling off after the report, we see Netflix as a victim of its own success. Its business continues to show incredible strength, but maintaining the recent level of success is unrealistic in our view. We’re raising our fair value estimate to $440 from $425 on the back of the strong quarter but still see the stock as a bit expensive.Netflix added 9.3 million net global subscribers in the quarter to bring its total to over 37 million net additions in the past year. The 16% growth in the subscriber base over that span led to 15% year-over-year sales growth despite a 3-percentage-point currency headwind. The operating margin exceeded 28%, up 7 percentage points year over year and about 6 percentage points better than any quarter in 2023. However, while second-quarter guidance implies an acceleration in revenue growth, full-year guidance of 13%-15% growth implies a deceleration in the second half. Management raised its full-year operating margin target by 1 percentage point to 25%, which also means some rationalization in the second half.After adding 2.5 million US and Canada subscribers in the quarter, Netflix now has more than 81 million subscribers in the region. With household penetration closing in on 60% and little remaining opportunity to transition nonpaying users to paid users with the password-sharing crackdown that was widely implemented in 2023, we expect UCAN additions will decline materially from recent levels, leaving the firm to rely on pricing and advertising to keep sales growth high in the region.

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Netflix Earnings: Performance and Outlook Are Very Impressive, but Subscriber Growth Should Moderate Matthew Dolgin, CFA,Senior Equity Analyst,24 Jan 2024

Netflix reported significant fourth-quarter subscriber additions with strength across all regions, and average revenue per member was up after several quarters of decline, resulting in significant sales growth acceleration. We see further tailwinds to ARM over the next few years but believe subscriber growth will slow. We're raising our fair value estimate to $425 from $410 after incorporating the results and management's 2024 outlook, but we believe the stock has gotten ahead of itself even as we expect Netflix to remain dominant.Fourth-quarter revenue grew 13% year over year as Netflix added over 13 million net global subscribers, the most since the first quarter of 2020, and every region added more net subscribers than it had since the first or second quarter of 2020 when pandemic-related lockdowns had just begun. The firm added 2.8 million net subscribers in the U.S. and Canada. While we project subscriber growth will remain relatively high, we think the catalysts that led to outsize growth last year will significantly subside in 2024. Netflix began to crack down on password sharing at the beginning of 2023 and gradually rolled out the policy in different markets while simultaneously offering new options for lower-priced ad-supported subscriptions or member additions to existing plans.ARM grew 1% year over year in the fourth quarter, helped by price increases in the U.S., the U.K., and France, and we think Netflix has room to increase ARM materially over the next few years on the back of its advertising revenue stream.Netflix continues to realize significant operating leverage. The firm's operating margin was 17% in the fourth quarter and over 20% for the full year, up nearly 3 percentage points from 2022. Management expects a margin of 24% in 2024. Free cash flow was about $7 billion in 2023, but about $1 billion in anticipated content spending was delayed due to the Hollywood writers and actors strikes. We project over $6 billion in free cash flow in 2024.

Netflix: We Expect the Firm's Lead on Competitors to Continue Matthew Dolgin, CFA,Senior Equity Analyst,30 Nov 2023

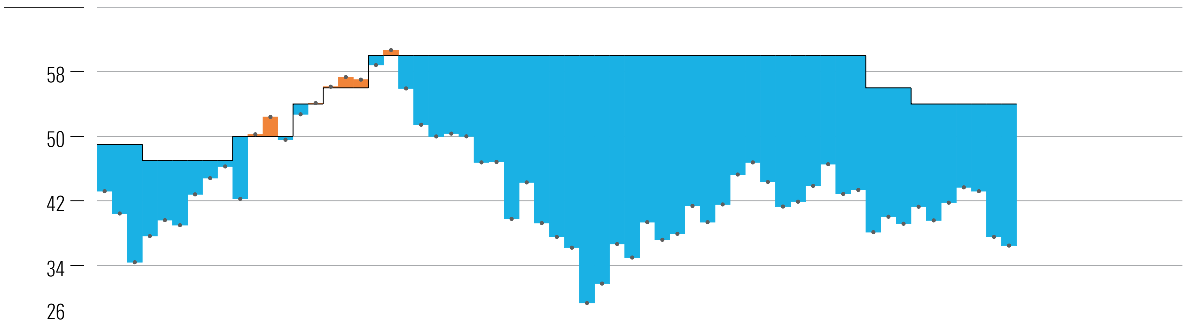
After taking a critical look at Netflix, we are raising our fair value estimate to $410 from $350 while maintaining our narrow moat rating and revising our Morningstar Capital Allocation Rating to Exemplary, from Standard. We expect Netflix to maintain its leading position in the television streaming industry at least throughout the decade.Netflix has had a different strategy than peers. It has thus far forgone the temptation to offer live sports programming, which was wise considering our view that it would've had to overpay to attract major sports leagues. It has also chosen to grow organically from the ground up, building its business with no head start in terms of content ownership or a foothold in the traditional media business. These decisions now give Netflix the advantage of not having to manage a declining legacy media business, and it isn't burdened with expensive sports contracts or a subscriber base that is dependent on retaining sports rights.These factors play into our decision to award the firm an exemplary capital allocation rating. Management had the foresight to see that the success it found in the DVD-by-mail subscription business would be fleeting as technology and video consumption evolved, and it was willing to go all in to move to an entirely different business model. At a time when capital was cheap and equity investors were very willing to fund money-losing enterprises with hopes of a future payoff, Netflix management took advantage. With a prudent mixture of equity and low-interest-rate debt, Netflix transitioned its business, funding it through years of negative cash flow to build an industry-leading streaming customer base, expand to numerous international markets, and rev up its production capabilities for original content.

Morningstar Equity Analyst Report | Report as of 14 Jan 2025 23:54, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

Netflix Inc NFLX ★★ 14 Jan 2025 22:30, UTC

Competitors Price vs. Fair Value

Comcast Corp Class A CMCSA

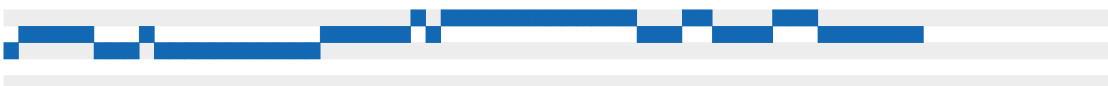


Fair Value: 54.00
23 Jul 2024 18:10, UTC

Last Close: 36.45
Overvalued
Undervalued

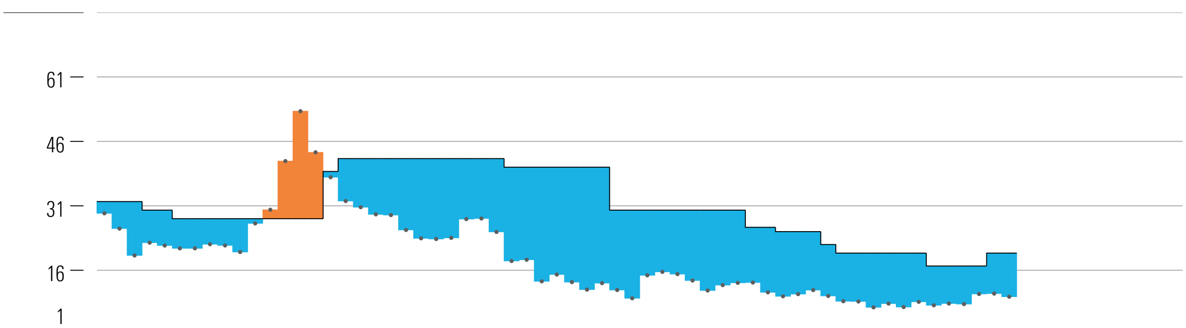
	2020	2021	2022	2023	2024	YTD	
	1.05	0.84	0.58	0.73	0.70	0.67	Price/Fair Value
	18.52	-2.08	-28.41	28.65	-11.63	-2.05	Total Return %

Morningstar Rating



Total Return % as of 13 Jan 2025. Last Close as of 13 Jan 2025. Fair Value as of 23 Jul 2024 18:10, UTC.

Warner Bros. Discovery Inc Ordinary Shares - Class A WBD

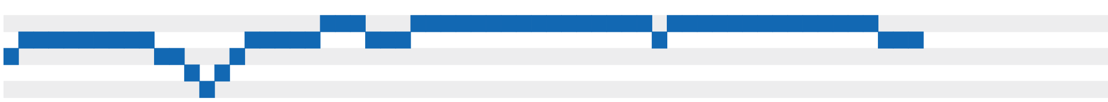


Fair Value: 20.00
10 Dec 2024 03:40, UTC

Last Close: 9.84
Overvalued
Undervalued

	2020	2021	2022	2023	2024	YTD	
	1.07	0.56	0.32	0.46	0.53	0.49	Price/Fair Value
	-8.09	-21.77	-59.73	20.04	-7.12	-6.91	Total Return %

Morningstar Rating



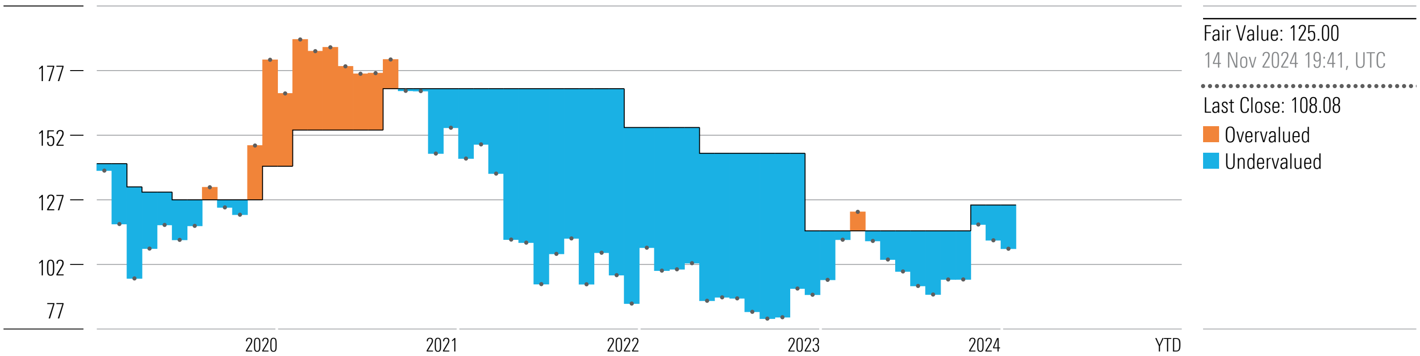
Total Return % as of 13 Jan 2025. Last Close as of 13 Jan 2025. Fair Value as of 10 Dec 2024 03:40, UTC.

Morningstar Equity Analyst Report | Report as of 14 Jan 2025 23:54, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

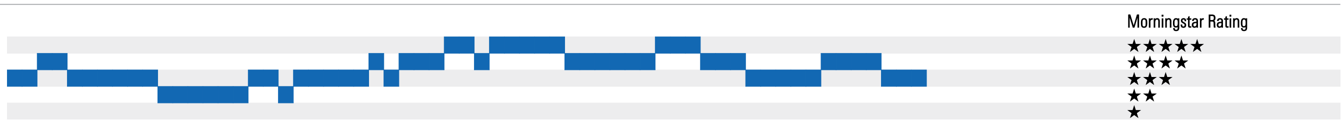
Netflix Inc NFLX ★★ 14 Jan 2025 22:30, UTC

Competitors Price vs. Fair Value

The Walt Disney Co DIS



	2020	2021	2022	2023	2024	YTD
Price/Fair Value	1.29	0.91	0.56	0.79	0.89	0.87
Total Return %	25.27	-14.51	-43.91	4.27	24.38	-2.94



Total Return % as of 13 Jan 2025. Last Close as of 13 Jan 2025. Fair Value as of 14 Nov 2024 19:41, UTC.

Netflix Inc NFLX ★★ 14 Jan 2025 22:30, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
840.29 USD 13 Jan 2025	550.00 USD 18 Oct 2024 03:37, UTC	1.53	354.11 USD Bil 14 Jan 2025	Narrow	Large Growth	High	Exemplary	1 Jan 2025 06:00, UTC

Morningstar Historical Summary

Financials as of 30 Sep 2024

Fiscal Year, ends 31 Dec	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	YTD	TTM
Revenue (USD K)	6,779,511	8,830,669	11,692,713	15,794,341	20,156,447	24,996,056	29,697,844	31,615,550	33,723,297	—	28,754,453	37,587,278
Revenue Growth %	23.2	30.3	32.4	35.1	27.6	24.0	18.8	6.5	6.7	—	15.5	14.8
EBITDA (USD K)	3,852,871	5,335,599	7,108,407	9,262,196	12,008,080	15,507,911	19,044,502	20,332,955	21,508,387	—	19,746,910	24,959,690
EBITDA Margin %	56.8	60.4	60.8	58.6	59.6	62.0	64.1	64.3	63.8	—	68.7	66.4
Operating Income (USD K)	305,826	379,793	838,679	1,605,226	2,604,254	4,585,289	6,194,509	5,632,831	6,954,003	—	8,144,848	9,640,957
Operating Margin %	4.5	4.3	7.2	10.2	12.9	18.3	20.9	17.8	20.6	—	28.3	25.7
Net Income (USD K)	122,641	186,678	558,929	1,211,242	1,866,916	2,761,395	5,116,228	4,491,924	5,407,990	—	6,843,024	7,780,862
Net Margin %	1.8	2.1	4.8	7.7	9.3	11.1	17.2	14.2	16.0	—	23.8	20.7
Diluted Shares Outstanding (K)	436,456	438,652	446,814	451,244	451,765	454,208	455,372	451,290	449,498	—	439,757	440,827
Diluted Earnings Per Share (USD)	0.28	0.43	1.25	2.68	4.13	6.08	11.24	9.95	12.03	—	15.56	17.69
Dividends Per Share (USD)	—	—	—	—	—	—	—	—	—	—	—	—

Valuation as of 31 Dec 2024

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Recent Qtr	TTM
Price/Sales	7.7	6.6	7.8	8.1	7.7	10.3	9.6	4.2	6.7	10.4	10.4	10.4
Price/Earnings	303.0	333.3	192.3	95.2	104.2	87.7	54.3	26.4	48.5	50.5	50.5	50.5
Price/Cash Flow	-91.7	-46.7	-46.1	-62.5	-54.9	222.2	416.7	113.6	36.2	52.4	52.4	52.4
Dividend Yield %	—	—	—	—	—	—	—	—	—	—	—	—
Price/Book	22.6	21.1	25.0	23.3	20.7	23.2	17.5	6.4	9.5	16.8	16.8	16.8
EV/EBITDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Operating Performance / Profitability as of 30 Sep 2024

Fiscal Year, ends 31 Dec	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	YTD	TTM
ROA %	1.4	1.6	3.4	5.4	6.2	7.5	12.2	9.6	11.1	—	—	15.3
ROE %	6.0	7.6	17.8	27.5	29.1	29.6	38.0	24.5	26.2	—	—	34.7
ROIC %	7.2	5.1	9.6	12.4	12.4	15.8	18.5	14.6	17.2	—	—	22.5
Asset Turnover	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	—	—	0.7

Financial Leverage

Fiscal Year, ends 31 Dec	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Recent Qtr	TTM
Debt/Capital %	51.6	55.7	64.5	66.4	66.1	58.8	48.1	40.9	40.7	—	38.4	—
Equity/Assets %	21.8	19.7	18.8	20.2	22.3	28.2	35.5	42.8	42.2	—	43.5	—
Total Debt/EBITDA	0.6	0.6	0.9	1.1	1.2	1.1	0.8	0.7	0.7	—	0.8	—
EBITDA/Interest Expense	23.5	35.5	20.1	22.0	19.2	11.2	24.9	28.8	28.7	Infinite	37.5	33.3

Morningstar Analyst Historical/Forecast Summary as of 17 Oct 2024

Financials

			Estimates		
Fiscal Year, ends 31 Dec 2023	2022	2023	2024	2025	2026
Revenue (USD Mil)	31,616	33,723	38,791	43,046	47,723
Revenue Growth %	6.5	6.7	15.0	11.0	10.9
EBITDA (USD Mil)	7,079	8,162	11,410	13,401	15,251
EBITDA Margin %	22.4	24.2	29.4	31.1	32.0
Operating Income (USD Mil)	5,633	6,954	10,401	12,150	13,874
Operating Margin %	17.8	20.6	26.8	28.2	29.1
Net Income (USD Mil)	4,492	5,408	8,665	10,240	11,557
Net Margin %	14.2	16.0	22.3	23.8	24.2
Diluted Shares Outstanding (Mil)	451	449	439	438	438
Diluted Earnings Per Share(USD)	9.95	12.03	19.72	23.38	26.39
Dividends Per Share(USD)	0.00	0.00	0.00	0.00	0.00

Forward Valuation

			Estimates		
	2022	2023	2024	2025	2026
Price/Sales	4.2	6.3	9.1	8.2	7.4
Price/Earnings	29.6	40.5	42.0	35.4	31.4
Price/Cash Flow	—	—	—	—	—
Dividend Yield %	—	—	—	—	—
Price/Book	6.4	10.6	12.4	9.2	7.1
EV/EBITDA	19.6	26.9	31.6	26.9	23.7

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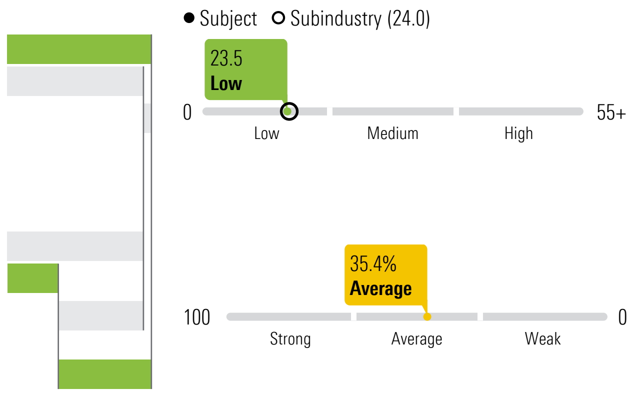
Netflix Inc NFLX ★★ 14 Jan 2025 22:30, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
840.29 USD 13 Jan 2025	550.00 USD 18 Oct 2024 03:37, UTC	1.53	354.11 USD Bil 14 Jan 2025	Narrow	Large Growth	High	Exemplary	1 Jan 2025 06:00, UTC

ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	23.5
– Manageable Risk	22.2
Unmanageable Risk[2]	**1.3**
Management	
Manageable Risk	22.2
– Managed Risk[3]	7.8
Management Gap[4]	**14.4**
Overall Unmanaged Risk	**15.6**



- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- Management measures a company's ability to manage ESG risks through its commitments and actions
- Management assesses a company's efficiency on ESG programs, practices, and policies
- Management score ranges from 0-100% showing how much manageable risk a company is managing

ESG Risk Rating

ESG Risk Ratings measure the degree to which a company's value is impacted by environmental, social, and governance risks, by evaluating the company's ability to manage the ESG risks it faces.

1. A company's Exposure to material ESG issues 2. Unmanageable Risk refers to risks that are inherent to a particular business model that cannot be managed by programs or initiatives 3. Managed Risk = Manageable Risk multiplied by a Management score of 35.4% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk = Management Gap plus Unmanageable Risk

ESG Risk Rating Assessment[5]

ESG Risk Rating is of Jan 01, 2025. Highest Controversy Level is as of Jan 08, 2025. Sustainalytics Subindustry: Movies and Entertainment. Sustainalytics provides Morningstar with company ESG ratings and metrics on a monthly basis and as such, the ratings in Morningstar may not necessarily reflect current Sustainalytics' scores for the company. For the most up to date rating and more information, please visit: sustainalytics.com/esg-ratings/.

Peer Analysis 01 Jan 2025

Peers are selected from the company's Sustainalytics-defined Subindustry and are displayed based on the closest market cap values

Company Name	Exposure		Management		ESG Risk Rating	
Netflix Inc	23.5 | Low	0 – 55+	35.4 | Average	100 – 0	15.6 | Low	0 – 40+
The Walt Disney Co	27.0 | Low	0 – 55+	46.8 | Average	100 – 0	15.1 | Low	0 – 40+
Comcast Corp	42.0 | Medium	0 – 55+	52.3 | Strong	100 – 0	22.3 | Medium	0 – 40+
Warner Bros. Discovery Inc	26.0 | Low	0 – 55+	31.7 | Average	100 – 0	18.1 | Low	0 – 40+
Reservoir Media Inc	31.0 | Low	0 – 55+	26.3 | Average	100 – 0	23.2 | Medium	0 – 40+

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Appendix

Historical Morningstar Rating

Netflix Inc NFLX 14 Jan 2025 22:30, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	—	—	—	—	—	★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★	★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★	★★	★★★	★★★	★★	★★	★★	★★★	★★★	★★★	★★★	★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★	★★	★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★	★	★	★	★	★	★	★	★	★	★	★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★	★	★	★	★	★	★	★	★	★	★	★

Comcast Corp Class A CMCSA 14 Jan 2025 22:32, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	—	—	—	—	—	★★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★★	★★★★	★★★★	★★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★

Warner Bros. Discovery Inc Ordinary Shares - Class A WBD 14 Jan 2025 22:30, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	—	—	—	—	—	★★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★	★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★

Morningstar Equity Analyst Report | Report as of 14 Jan 2025 23:54, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

The Walt Disney Co DIS 14 Jan 2025 22:31, UTC

Dec 2025 —	Nov 2025 —	Oct 2025 —	Sep 2025 —	Aug 2025 —	Jul 2025 —	Jun 2025 —	May 2025 —	Apr 2025 —	Mar 2025 —	Feb 2025 —	Jan 2025 ★★★
Dec 2024 ★★★	Nov 2024 ★★★	Oct 2024 ★★★★	Sep 2024 ★★★★	Aug 2024 ★★★★	Jul 2024 ★★★★	Jun 2024 ★★★	May 2024 ★★★	Apr 2024 ★★★	Mar 2024 ★★★	Feb 2024 ★★★	Jan 2024 ★★★★
Dec 2023 ★★★★	Nov 2023 ★★★★	Oct 2023 ★★★★★	Sep 2023 ★★★★★	Aug 2023 ★★★★★	Jul 2023 ★★★★	Jun 2023 ★★★★	May 2023 ★★★★	Apr 2023 ★★★★	Mar 2023 ★★★★	Feb 2023 ★★★★	Jan 2023 ★★★★★
Dec 2022 ★★★★★	Nov 2022 ★★★★★	Oct 2022 ★★★★★	Sep 2022 ★★★★★	Aug 2022 ★★★★	Jul 2022 ★★★★★	Jun 2022 ★★★★★	May 2022 ★★★★	Apr 2022 ★★★★	Mar 2022 ★★★★	Feb 2022 ★★★	Jan 2022 ★★★★
Dec 2021 ★★★	Nov 2021 ★★★	Oct 2021 ★★★	Sep 2021 ★★★	Aug 2021 ★★★	Jul 2021 ★★	Jun 2021 ★★★	May 2021 ★★★	Apr 2021 ★★	Mar 2021 ★★	Feb 2021 ★★	Jan 2021 ★★
Dec 2020 ★★	Nov 2020 ★★	Oct 2020 ★★★	Sep 2020 ★★★	Aug 2020 ★★★	Jul 2020 ★★★	Jun 2020 ★★★	May 2020 ★★★	Apr 2020 ★★★★	Mar 2020 ★★★★	Feb 2020 ★★★	Jan 2020 ★★★

Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

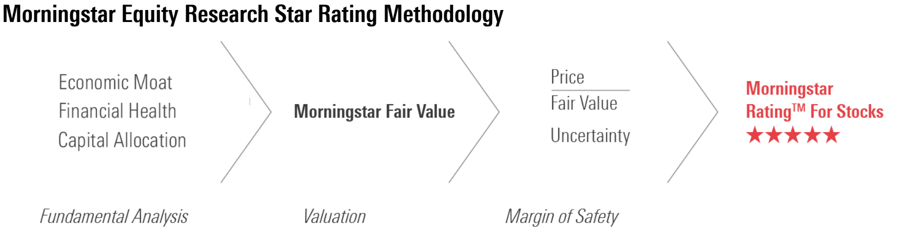
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating is designed to capture the range of potential outcomes for a company's intrinsic value. This rating is used to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating is aimed at identifying the confidence we should have in assigning a fair value estimate for a given stock.

Our Uncertainty Rating is meant to take into account anything that can increase the potential dispersion of future outcomes for the intrinsic value of a company, and any-

Morningstar Equity Research Star Rating Methodology



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thing that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the potential dispersion of outcomes, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the Uncertainty Rating provides guidance in portfolio construction based on risk tolerance.

Our Uncertainty Ratings are: Low, Medium, High, Very High, and Extreme.

	Margin of Safety	
Qualitative Analysis Uncertainty Ratings	★★★★★Rating	★Rating
Low	20% Discount	25% Premium
Medium	30% Discount	35% Premium
High	40% Discount	55% Premium
Very High	50% Discount	75% Premium
Extreme	75% Discount	300% Premium

Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly, when a stock hits 1 star, we expect there is a 75% chance that the intrinsic value of that stock lies below the current market price.

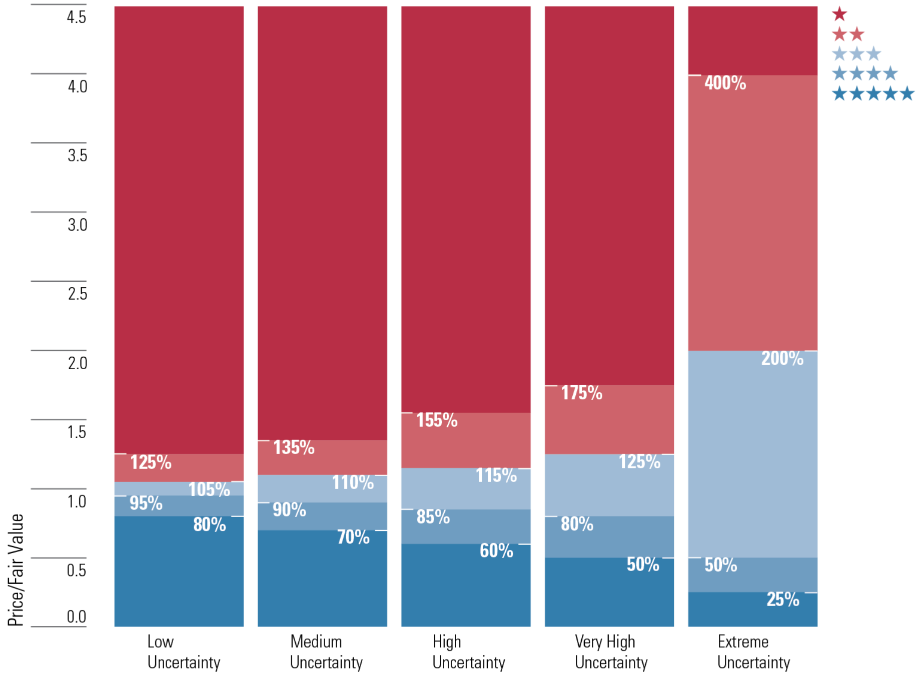
4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com

Morningstar Star Rating for Stocks

Morningstar Equity Research Star Rating Methodology



Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider compan-

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ies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

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Sustainalytics ESG Risk Rating Assessment: The ESG Risk Rating Assessment is provided by Sustainalytics; a Morningstar company.

Sustainalytics' ESG Risk Ratings measure the degree to which company's economic value at risk is driven by environment, social and governance (ESG) factors.

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score. Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

Based on their quantitative scores, companies are grouped into one of five Risk Categories (negligible, low, medium, high, severe). These risk categories are absolute, meaning that a 'high risk' assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered.

The ESG Risk Rating Assessment is a visual representation of Sustainalytics ESG Risk Categories on a 1 to 5 scale. Companies with Negligible Risk = 5 Globes, Low Risk = 4, Medium Risk = 3 Globes, High Risk = 2 Globes, Severe Risk = 1 Globe. For more information, please visit sustainalytics.com/esg-ratings/

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