Opinion: Netflix stock is a buy right now — for these 10 reasons

By **Michael Brush**
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Don't fear Disney; this is a bargain price for Netflix

This is no Disney show.

With Walt Disney Co. and Apple gearing up to launch what will likely be awesome streaming video services in the next few months, Netflix couldn't have picked a worse time to drop bad news on subscriber growth.

But it did just that in a July 18 second-quarter earnings report. The news has sent panicky investors toward the exits, pushing Netflix shares **NFLX, -0.52%** down 25% from the highs of early July.

The sellers are making a big mistake. They are offering you bargain prices on what is going to be one of the top media companies for years to come. Take advantage of the discount and buy Netflix.

"If you have a two-year window, the stock is a buy," says Tom Vandeventer, portfolio manager of the Tocqueville Opportunity Fund **TOPPX, +1.17%** .

"I don't think [Netflix's] model is broken. Long term, this company has a lot of earnings power," says Vandeventer, whose fund ranks in the top percentile of its Morningstar category of midcap growth funds year to date.

Here's why Disney **DIS, +0.38%** and Apple **AAPL, +1.72%** and the like aren't the threat people think they are, and why Netflix is going to be just fine:

1. Second-quarter issues are par for the course, and subscriber growth will get back on track soon

In the past four years Netflix has missed second-quarter guidance three times, says Deutsche Bank Securities analyst Bryan Kraft. There are several perfectly acceptable reasons: The quarter usually brings less new content. It's often when Netflix hikes prices, as it did again this year. Netflix also faced tougher competition from HBO's "Game of Thrones" and warm weather.

Likewise, there are good reasons to think subscriber growth will return in the second half. Above all, content offerings really pick up, notes JPMorgan Chase analyst Doug Anmuth. New seasons of “Stranger Things,” “The Crown” and “Orange Is the New Black” will hit during that time, along with popular shows like “Money Heist” and promising films like “The Irishman” (from Martin Scorsese, with Robert De Niro and Al Pacino) and “6 Underground.”

2. Netflix and Disney aren’t interchangeable

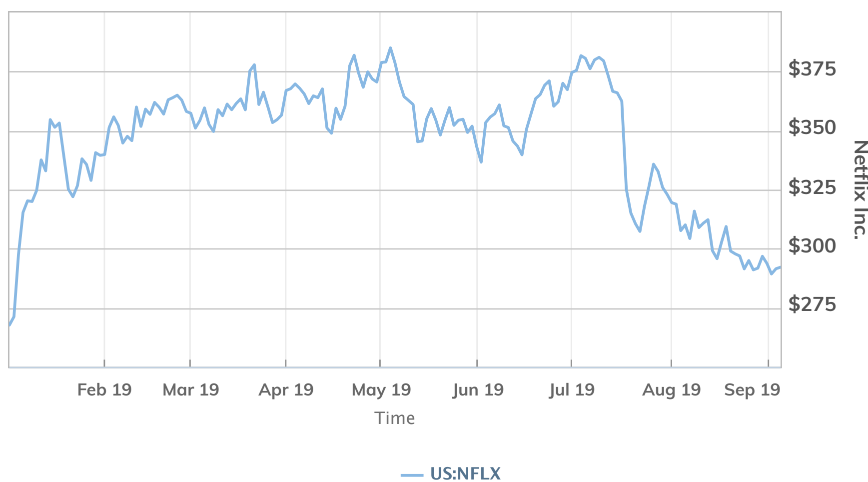
Disney has a reputation for family fare. In contrast, Netflix offers edgier content. So they’re not entirely direct competitors. It’s hard to imagine Dave Chappelle’s politically incorrect “Sticks & Stones” coming out of Disney. And think of how different “Orange Is the New Black” would be if it had been processed through the Disney machine. Would it have been dumbed down to support aftermarket sales of Piper Chapman dolls?

3. Viewers really like Netflix content

Investors worry that Netflix is losing Disney content as well as popular shows like “Friends” and “The Office.” But Netflix subscribers will take it in stride. “People focus on these shows as the core of Netflix content, but that has never been the case,” says Alexandra Cowie, a media analyst with Gabelli Funds who is bullish on Netflix.

Yes, “The Office” and “Friends” are regularly top shows. But six of the 10 most viewed titles recently were original Netflix content, points out Cowie, including “House of Cards,” “Narcos” and “The Haunting of Hill House.” None of the top 10 was from Disney. Around 80% of millennials think Netflix has the best original content, says Cowie, citing data from Convergence Research Group.

Keep in mind that despite the loss of Disney, Netflix will still have lots of third-party content from major studios including Sony and Paramount as well as the CW Television Network, notes Morgan Stanley analyst Benjamin Swinburne. “Not every studio can or will go direct-to-consumer,” he says.



4. It’s not winner-take-all

“There’s this idea that you have to pick one. But we all know that’s not the case because we all know how much TV we watch,” says Cowie.

Indeed, because streaming services cost around $10 to $13 a month, many consumers can sign up for several, notes Jim Mueller, a senior analyst at the Motley Fool who is bullish on Netflix.

Echoing the "multiple winners" theme, BMO Capital Markets Daniel Salmon recommends Netflix, Amazon.com **AMZN, +1.75%** and Disney as a "collective investment in the global streaming race."

5. There's a fire hose of potential new subscribers

Cord-cutting will continue to free up potential customers in a big way. Cowie cites Roku **ROKU, -3.03%** growth metrics as a proxy for consumer interest in streaming because its devices offer such a handy gateway. Active accounts and hours streamed at Roku have been growing at an average of 40% and 70%, respectively, on year-over-year bases for the past six quarters, she notes.

"Goodness knows what will happen if investors start thinking of Netflix as a smartphone app and realize that there will be 3 billion smartphones roaming the planet in a few years," says RBC Capital Markets analyst Mark Mahaney.

6. Netflix has more firepower for content

Disney is perceived as a big threat, but Netflix really has it beat in terms of spending power. Last year, Netflix produced $15.8 billion in revenue, growing to $20 billion this year, points out Charles Lemonides, chief investment officer of the hedge fund ValueWorks. In contrast, Disney's studio entertainment division brought in $10 billion in revenue in 2018 and isn't growing rapidly. The upshot: Netflix has a lot more money to spend on scripted content.

The advantage is bigger than it seems because so much of Disney's content spend gets sucked up by big-budget projects, not an area where Netflix competes. "So Netflix has more money to spend on the next 'Orange is the New Black,' " says Lemonides.

Keep in mind that while Netflix missed on subscriber growth in the second quarter, in part due to price hikes, it hit its revenue-growth target. This matters for two reasons: It shows Netflix has the pricing power to boost revenue per user, an important metric, and good revenue growth supports more spending on content, which is highly predictive of subscriber adds, says Goldman Sachs analyst Heath Terry.

7. Netflix has a big information advantage

The company has been closely watching subscribers for years — from what shows they prefer to where they pause and what scenes they repeat. "This lets them learn about what content works in ways that others can't," says Lemonides. "In a way it is creepy, but it is a good advantage to have."

It gives Netflix a huge information advantage when buying content and negotiating with producers. Despite the mismatch, they still really like working with Netflix because of the freedom and autonomy they get, says Jeff Sica, CEO of Circle Squared, which has helped fund producers creating content for Netflix.

8. There's big potential abroad

Netflix currently has 91 million subscribers abroad and 60 million in the U.S. Given that there are billions of broadband accounts worldwide, the growth potential for Netflix remains daunting, says Motley Fool's Mueller. He thinks foreign demand will support a double in the Netflix subscriber base over five years, which will sharply ramp up earnings and cash-flow growth. "They are not going to double their content spend. So a whole lot [of] revenue drops to the bottom line."

9. Netflix shares look cheap

As the worst-performing FAANG this year, Netflix now looks arguably cheap. The stock is up 8.7% in 2019 through Tuesday, compared with 12% for Alphabet **GOOG, +2.12% GOOGL, +2.12%** , 17.3% for Amazon, 31% for Apple and 38% for Facebook **FB, +1.69%** . The S&P 500 index **SPX, +1.30%** has gained 14.45%.

Using discounted-cash-flow analysis, Cowie, the Gabelli analyst, thinks Netflix is worth $380 a share right now, 30% higher than recent prices near $291. At least one company insider agrees: A director put $2 million into the stock at around $309 in early August.

10. Netflix faces less regulatory wrath

Since it's not ad-supported, Netflix doesn't mine and share much personal information, a hot issue that has politicians on both sides of the aisle gunning for Alphabet and Facebook, points out Mahaney of RBC Capital Markets. It also helps that Netflix CEO Reed Hastings doesn't own a national newspaper regularly engaged in critical coverage of President Donald Trump — a potential problem for Washington Post owner Jeff Bezos and Amazon.com.

*At the time of publication, Michael Brush had no positions in any stocks mentioned in this column. Brush has suggested DIS, NFLX, FB, GOOGL and AMZN in his stock newsletter **Brush Up on Stocks**. Brush is a Manhattan-based financial writer who has covered business for the New York Times and The Economist Group, and he attended Columbia Business School in the Knight-Bagehot program. Vandeventer subscribes to "Brush Up on Stocks."*

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