WHY NETFLIX ISN'T IN WISDOMTREE'S GROWTH LEADERS FUND – AND HASN'T EVER BEEN

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FAANG is now FAMGA (Facebook, Apple, Microsoft, Google, Amazon). This is the message Applico has been communicating for the past couple years, dating back to Alex's Fox Business interview in 2019. And since Netflix's annual report was released this month, Netflix's high-growth tech story has been debunked. Instead, Netflix is just a movie studio with better digital pipes than its competitors. And, unfortunately for Netflix, those pipes can be replicated.

Why is it that Netflix has fallen out of grace so quickly with investors? Because it's not a platform business. And that's precisely why it's not in the WisdomTree Growth Leaders Fund (PLAT), which seeks to track the price and yield performance, before fees and expenses, of the WisdomTree Growth Leaders Index (WTMDPL).

A platform business connects two user groups together: consumers and producers (in this case, content creators). Let's compare YouTube versus Netflix as a comparison of platform versus linear. YouTube has millions of content creators who willingly contribute videos onto the YouTube platform—for free! YouTube doesn't have to pay licensing fees or make upfront payments for content. Said another way, almost all of YouTube's content sits off the balance sheet. It's contributed onto the platform by content creators—producers—who hope to gain audience and/or revenue share from advertising.

Netflix, on the other hand, has more than **$26 billion** of "non-current content assets" on its balance sheet as of April 22, 2021. And its profitability is entirely dependent on how quickly, or slowly, it depreciates those content assets. Not to mention, after achieving positive free cash flow (FCF) in 2020, the company has signaled a return to negative free cash flow as movie production ramps up again.

Outside of the financials, let's take a step back and look more broadly at the competitive landscape and what really matters for investors: **growth**.

Netflix's Competitive Landscape

Netflix enjoyed rapid growth for many years while it was the only game in town, growing at 30% CAGR for the last **five** years. However, in 18 months' time, that story has rapidly changed. How is it possible for such a dominant, heralded company like Netflix to fall from grace so quickly?

Platform businesses enjoy such high valuations and margins because they can remain the only game in town. Platform markets have a winner-take-all dynamic because they aggregate both demand and supply. When supply is fragmented, platforms thrive. YouTube has a network of millions of content creators. It's nearly impossible to convince a material portion of those content creators to use another network and drop YouTube because of how network effects work. As demand grows, so does supply, and vice versa—this is further explained in Metcalfe's Law and Moazed's book, *Modern Monopolies*.

Many have tried to dethrone YouTube, like IAC's Vimeo. Barry Diller, billionaire and savvy platform expert, also owns dominant platforms in travel and home services with Expedia, Angie HomeAdvisor, Match and Tinder. Mr. Diller intimately understands platform dynamics. For that reason, he recognized that Vimeo's business model needed to pivot from trying to compete directly with YouTube. Instead, Vimeo has become a linear SaaS provider of tools to content creators—and is doing quite well with its new positioning.

Platform markets only afford one to two winners at maturity. Netflix is not a platform and doesn't have supply-side barriers to entry. That's why more than five material competitors have not only launched in the past 18 months, but have made serious subscriber gains in that same period of time. Just 18 months! Disney+ already has more than 90 million subscribers. Behind Disney+, HBO Max launched in May 2020 and has more than 40 million subscribers. Peacock has more than 30 million subscribers from Comcast. And don't forget about the material subscriber gains for Apple TV+, Amazon Prime Video and Paramount+ from Viacom/CBS.

In the absence of competition exists unabated growth. Consistent, high growth is what investors reward in today's environment. Platform markets at maturity provide winner-take-all dynamics and therefore an absence of competition—hence, these businesses are modern monopolies. Unfortunately for Netflix, its leadership never made it a priority to evolve its business model and embrace platform dynamics as we've seen Spotify do in recent years.

Spotify has similar dynamics, where its supply of musicians is consolidated and not fragmented. While Spotify has huge demand, it doesn't have supply-side barriers to entry. That is, until it embraced podcasting. Podcasting is highly fragmented, and we've seen Spotify invest aggressively with Joe Rogan and other key podcasting influencers. I think this is a great strategy and a sign of great leadership to continuously evolve the business model—unlike Netflix, whose stagnant business model has the look of a one-hit wonder. Perhaps it's a good time for Reed Hastings to transition to greener pastures.

Please visit PLAT's Fund detail page for its current holdings.

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Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

Free Cash Flow : A measure of how much cash is left in the company after taking into account all the necessary expenses, including net capital expenditures.

Compound Annual Growth Rate (CAGR) : The mean annual growth rate of an investment over a specified period of time longer than one year.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Software-as-a-Service (SaaS) : Software applications provided over a network connectio.