

In 1997, Reed Hastings, Co-founder of Netflix suffered a major inconvenience, one that would revolutionise how the world watches media content. He forgot to return his video rental, Apollo 13 and had to pay a 40-dollar late fee. He was so embarrassed he hid it from his wife. This got him thinking of a way to make late fees obsolete and the idea for Netflix was born.

From DVDs to On Demand Streaming

Netflix started out as a company that would mail DVDs to paying customers. After testing out over 200 different mailing packages (by mailing them to himself), Hastings found out that he could safely mail a DVD for the same price as a first class mail stamp.

When it first opened, Netflix was purely a movie rental service. Users ordered movies on the Netflix website, and received DVDs in the post. When they were finished with them, they would simply post them back to Netflix in the envelopes provided. There were no late fees, but you couldn't rent more until you returned the ones you had.

Not long after opening they signed deals with Hewett Packard, Toshiba, and Sony whereby they offered free DVD rentals if you bought a new DVD player. They also introduced, something which is engrained into our lives now, smart suggestion algorithms. Once a customer had rented enough titles Netflix could automatically suggest new movies that were likely to interest them. Nowadays we are so accustomed to Google and Facebook suggesting content to us, but back then this was practically unheard of.

Netflix first started offering Video on Demand streaming services in 2007. At first movie rights were hard to come by so the movies you could stream were pretty terrible, but then they signed a deal with premium cable outlet Starz which bought in Sony and Disney movies. Soon after that they signed deals with Paramount, Lionsgate and MGM and by 2020 more than 50% of the worlds video streaming was attributed to Netflix.

Netflix joins the stock exchange

In 2000 they were receiving over 10 000 DVD rental orders a day but was running at a loss. Part of the reason being that Netflix was taking the cash they were making and reinvesting into the business for growth. This is something that they continue to do today, last year alone research & development was \$1.83bn.

So, on the 23rd of May 2002 Netflix went public. Soon after things started looking up and they passed their one million subscriber mark and had their first profitable year.

True originality consists not in a new manner but in a new vision

Due to the increased cost of content streaming licenses Netflix looked at making their own content. In 2011 Netflix announced the production of their first piece of original content – House of Cards, which has been nominated for an astounding 56 Emmy Awards to date. The viewer algorithms helped them spot gaps in the market giving Netflix an edge on developing new shows as they can create original content based on what they know their customers want.

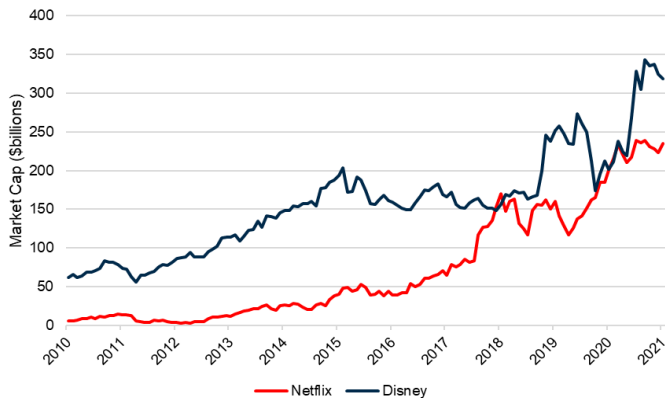
The Future

With a low barrier to entry, Netflix does have to deal with a growing number of competitors, with companies such as HBO, Apple, Disney & Hulu also creating original content. Many of these competitors have profitable businesses that can subsidize lower-cost streaming offerings as well as having very deep pockets (Disney current Revenue \$58.3bn and Amazon current revenue \$419bn) who continue to invest heavily in streaming.

Despite having numerous competitors on its tail, Netflix continues to do remarkably well. Its market cap has grown from \$5.6 billion in 2010 to \$239 billion in 2020. At one point their market cap even exceeded that of Disney.



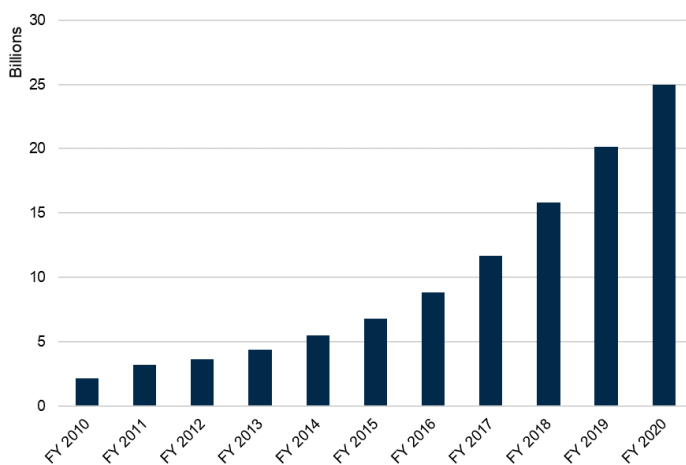
Figure 1: Netflix Market Cap vs. Disney



Source: Bloomberg

Netflix success has been amplified by the spread of coronavirus in 2020. Lockdowns across the globe led to a higher demand for streaming services. This was reflected in the FY 2020 financials. EBIT (Earnings before Income and Tax) grew by an impressive 33.2% (annualized) from 2010 to 2020 and revenue has increased from \$2.1 million in 2010 to \$24.9 billion over the same period.

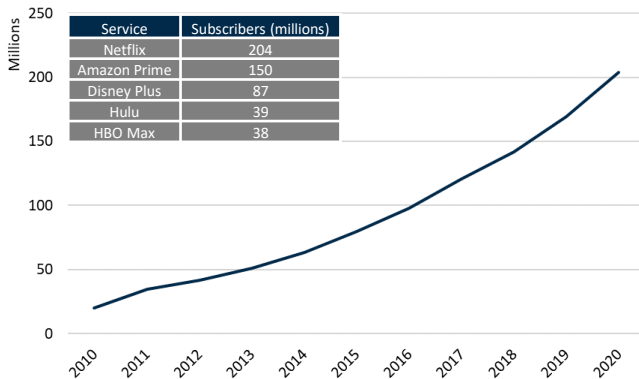
Figure 2: Netflix Revenue over time



Source: Bloomberg

Subscriber growth has also been on an upward trend. There are currently more than 200 million subscribers worldwide and is still by far the most popular streaming service globally.

Figure 3: Netflix Subscriber Growth



Source: Bloomberg

With extremely popular original content keeping viewers hooked and new seasons due to return for hit shows like Stranger Things, Money Heist and The Crown, Netflix is not going out of fashion. Investors have noticed how well Netflix has done in the past and are betting that their success will continue, by evidence of punchy valuations such as current EV/Sales of 9.3 and EV/EBIT of 40.