Buy Value, Get Growth

Perspectives: October 19th, 2022

This Perspective is about the impacts of disciplined executive intellectual honesty in the context of business culture, business strategy, and investing. We are using US listed **Netflix** as an example.

Netflix is without a shade of a doubt one of the most impressive businesses we have ever come across and acquired. As they tell the story, co-founders Messrs. Reed Hastings and Marc Randolph had an idea in 1997 **to rent DVD's by physical mail** [*a side note to my teenage daughters - a 'DVD' was a physical disc that we put into a physical device called a 'DVD-player' to watch movies with, and yes, we used to go fetch a DVD from a physical store, no matter the weather conditions.*]

With the launch of netflix.com in 1998 and subscription services in 1999, it heralded the beginning of the end for physical DVD rental stores, worldwide. This was proper disruption. A personalized movie recommendation service launched in 2000. Netflix listed on the stock markets in 2002 at US$1 per share, passed 1 million subscribers in 2003, and 5 million in 2006. Live streaming was introduced in 2007, and it passed 10 million subscribers in 2009, 25 million in 2012, and 50 million in 2014. Its first original feature film debuted in 2015, and in 2016 it reached 190 countries in 21 languages. Subscribers passed 100 million in 2017, the year it also won its first Academy Award. Netflix launched mobile games in 2021, when subscribers passed over the 200 million mark. As a business, Netflix turned 25 years old in August 2022.

On reflection, one of the most remarkable things about their origin story is that their original business idea, 'to rent DVD's by mail' was for all intents and purposes stillborn. In the late 1990's and early 2000's, everything was about the development of digital technologies and the stock markets were obsessed with technology stocks in what became known as the Y2K bubble.

Despite persistent *massive* growth in their business fundamentals, the Netflix share price stubbornly remained trading below US$10 per share for 10 *years*.

Only from 2013 onwards did the stock market seem to finally cotton on. Its share price eventually peaked at US$692 on November 17th, 2021. This made co-founder Reed Hastings, who today still owns over 5 million shares, a US Dollar multi-billionaire.

As we monitored the business over the years, one thing that became abundantly clear to us was how many times they have had to adapt and reinvent themselves. In fact, to us looking in from the outside they are constantly searching for new reasons to change. Listening to recent interviews with co-CEO Reed Hastings, who is now 61 years of age, it struck us that he somehow seems even more energized and excited about their opportunities and challenges today as he has ever been.

A stock market in which far too many market participants are incredibly short-term oriented can deliver a punishing blow to the share price of any highly valued stock priced for perceived perfection. Netflix' share price cratered from US$692 to a low point of US$166 on May 11th, 2022 - a decline of 76% in less than 6 months. What may have contributed to this was a public admission by the executives in early 2022 that they are leaving no stone unturned in challenging their own business model and strategy.

We found that the global corporate graveyards are full of the tombstones of companies that refused to see, acknowledge, and adapt to change. We also found that one of the most distinguishing characteristics of durable businesses is their sense of a restless internal search for continuous improvement. At the absolute best ones - those able to transcend multiple generations of owners and leaders - this characteristic is firmly embedded in its very organisational culture, at a level that tolerates no dissent nor compromise.

A mad short-term stock market reaction gave us as long-term investors an incredible opportunity to buy value and get growth.

Chart: Netflix Share Price 2002 - 2022 [*source: Google Finance*]

Our work continues...

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