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Worth Watching?: Assessing the Financial and Operational Health of Netflix

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Chapter 1: Introduction

Being heralded as both the death and re-birth of entire industry may seem contradicting and paradoxical, yet these titles have both be assigned to the streaming giant Netflix. Originally starting as, a by mail, DVD rental company, the company has morphed into one of the biggest players in both streaming and entertainment. With revenues in the billions and a rapid growth strategy that includes producing its original programming, Netflix has been deemed a company on the rise. With its stock pricing sky-rocketing and investments pouring in, it seems like Netflix is on the cusp of become the Amazon of the entertainment industry. Yet, with the all this hype and hyperbole the question needs to be asked: is Netflix truly a good investment? This is the question I sought to answer. While Netflix may be growing questions about its growth and stability must be answered. In order to answer these questions, I needed to quantify what a "good" investment was. After much thought and research I defined a good investment as a company that is in great "Operational Health" and "Financial Health."

When assessing Netflix's "Operational Health" I am referring to the non-financial aspects of the company. Specifically, I am referring to the history of the company, its leadership/management structure, its compliance and legal standing, the public reputation of the company, and its stockholder/ownership breakdown. When analyzing whether or not to invest in a company I believe it is important to look at it as a whole not strictly at the financials. While the financial statements and information tell an important story they do not tell the whole story. Looking purely at the numbers can be misleading and short-sighted as a perfectly financially healthy company can be mismanaged and plague with controversy and legal issues and the numbers simply have not "caught up." Thus, it is important to have a full understanding of the company in both its day-to-day operations and its financial standing.

First, I chose to inspect and recount the history of the company in order to give myself a clearer picture of the company, how it began, how it expanded into what it is now, and to see if I could find any positive or negative patterns, tendencies, problems, or controversies of the company. By looking at its past, speculating on what actions the company may take in the future becomes easier. Next, I decided to examine its leadership/management, this includes executives and the board of directors. Companies are often defined by the tone at the top and thus I felt like it was important to scrutinize the decisions, compensation, and make up of who is leading the company in order to issue an opinion about the future prospects of the company. The next category I surveyed was whether the company had any legal or compliance issues that may hurt the company's performance or survival. Furthermore, I looked to see if there were any patterns or recurring issues that would present long term problems for the company. In addition, I looked at the public reputation of the company. This area included how the company is portrayed in the media, how consumers view the company, the social action taken by the company, and any controversies Netflix has encountered. Public perception can make or break a company and thus it is any important aspect to analyze. Finally, I inspected the Stockholder/Ownership of the company. I believed it was important to get an idea of who the major shareholders and outside parties where that could potentially be influencing the decisions of the company. Additionally, I sought out any conflicts of interests or areas of concern that stemmed from investors while also seeing how Netflix responds to their shareholders, as potential investor will want to know if there voice is truly being heard.

Unlike the financial aspect of the company in which the “health” of the company can be easily quantified, the operational analysis of the company does not lend itself to measurements and analytics. Thus, the determination of operational health is a much more subjective process. However, in the analysis I remained as objective as problem, addressing and noting both the positive and negative aspects of the company under each operational category. In order to remain objective, I selected five categories in which there was little to no question about what qualified as “positive” or “negative.” For example, determining whether leadership’s ability has had a positive impact I looked at media, consumer, and investor reactions to major decisions made by the company. If they reacted negatively, then that would hurt their standing in my analysis or help if it was a positive reaction. In charting the history of the company examined both positive and negatives moments to paint an unbiased truthful picture of the company’s rise. Furthermore, any legal or compliance issues could be found through press, court documents, or SEC filings. In terms, of public relation it is easy to tell whether coverage paints the company in a positive or negative light. Finally, when analyzing it’s the Stockholder/Ownership of Netflix I examined its proxy and press coverage to see if I could find any issues of concern or conflict and examined how they company treated to and listened to their shareholders. Ultimately, I sought to analyze the company and its standing as whole and developed a way that I believed to be unbiased and fair.

In terms of financial health, the measurements are much easier to quantify than operational. To analyze the financial health of a company there are five subsets of ratios that are readily available through financial websites and companies, that act as indicators of financial performance. These ratios are calculated using the financial information made public by Netflix. I initially acquired the ratios through reliable financial websites such as Yahoo Finance and Morning Star. In order to ensure the accuracy of these number I performed the calculations myself. When selecting the ratios, I chose a set that represented different aspects of the company's financial health. The first subset of ratios I selected measured the liquidity ratio and efficiency of the company. Liquidity ratios are used to assess how "liquid", how fast the asset can be converted to cash or sold a company's assets are and how they can be used to pay off debts and obligations.[1] The efficiency ratios measure how well a company balances and uses the assets and liabilities they have at hand.[2] The ratios selected for this subset were the Current Ratio and Asset Turnover ratio.

The next ratios were solvency ratios measure the long-term financial viability of the company which includes the ability to properly pay off any long-term contracts and debts.[3] For this subset I selected the debt ratio and debt to equity ratio. The next set of ratios were the profitability ratios.[4] These ratios measure how a effectively a company produces revenue and earnings against the costs of revenues and operations. The profitability margins selected were profit margin and net return on assets. The final subset, Market Prospects, was different from the others as it did not calculate the current financial performance of Netflix but rather demonstrated how Netflix is viewed in the trading market and spoke to the future of the company.[5] The ratio selected for this category was the P/E ratio. The Ratios themselves will be explained in their respective sections in "Chapter 7."

Finally, to round out my financial analysis I analyzed the trends, changes, and patterns of select financial statement accounts and its stock price history. The select accounts include Netflix's total assets/liabilities, its total revenue, net income, cash and cash equivalents, current and non-current assets/liabilities, long term-debt, and cost of revenue. These accounts provide an accurate picture of the company's financial standing as they measure how much revenue Netflix generates, what the revenue costs, the make-up of the assets and liabilities, how liquid/profitable/solvent the company is, and overall the financial well-being of the company. This account analysis complements what the ratios indicate about the financial health of the company and overall provides a holistic view of the company from a financial perspective. Furthermore, I believe that the financial analysis as a whole combined with the operational analysis, provides an accurate representation of Netflix's past, present, and future and thus is an excellent way to assess whether the company is a worthy investment.

Chapter 2: History/Background

Tech entrepreneurs Marc Randolph and Reed Hastings founded Netflix in 1997. Hastings had founded the software company, Pure Software, where he met Randolph. They used their experience and expertise to create what would become the Gold standard in streaming. Netflix launched on April 14th, 1998, as online DVD rental and Delivery Company with only 925 titles.[6] Originally the business used a pay-per-rental system with no due dates and small late fees. The business introduced the subscription model they have become known for in the fall of 1999. The video company had their IPO on May 29th, 2002 selling 5.5 million shares of stock.[7] By 2005 had acquired the rights to over 35,000 titles and was renting out almost 1 million DVDs per day.[8] Because of the foresight of its founders, in 2007 Netflix shifted its primary focus from DVD rentals to online streaming of its video library.[9] Starting in Early 2013, the company started to produce original programming with the goal of eventually reaching 50% original content.[10] By the end of the third quarter in 2017, the company had grown to 109 million global subscribers over 190 countries.[11]

Netflix is known for its cutting-edge and innovative advances. The company has been credited by analysts and media with helping revolutionize and change the entertainment industry in addition to pioneering a new one distribution model[12]. Netflix considers itself the “leading internet television network” that streams 125 million hours of content both original and licensed programs created by other companies and networks.[13] Subscribers simply log on to Netflix.com and can select content from a vast, ever-changing library of programs. The content includes TV shows, comedy specials, movies, documentaries, etc. Subscribers sign up and choose one of three monthly plans:

one for $7.99, one for $10.99, and one for $13.99[14]. Internationally, there is similar pay structure with prices unique to each country. In addition to their global streaming business, in the United States, the company also rents DVDs to the customer's home. The main source of revenue for the company comes from these monthly subscriptions.[15]

The company has three main segments, Domestic Streaming, International Streaming, and Domestic DVD.[16] Domestic streaming is made up of the revenue produced by subscriptions from customers in the United States. The International streaming is composed of the revenue produced by the subscriptions of all customer, not in the United States. The final segment, Domestic DVD, is made up of revenue produced by the company's DVD rental service in the United States. Domestic Streaming brings in the most revenue (with 36% contribution margin), International Streaming the second most (with 10% contribution margin), and Domestic DVD the least(with a 52% contribution margin).[17] The company's main goal is "to grow [the company's] streaming membership business globally within the parameters of [its] profit margin targets."[18] In 2010, the company began its international expansion.

Netflix has identified several potential risks that could adversely affect the company in the future. First, the company's main revenue comes from one source, subscriptions, thus the financial success of the company directly depends maintain customer satisfaction and a strong reputation in order to keep and attract customers. Another is that while Netflix was a pioneer in online streaming, other services backed by incredibly large conglomerates like Amazon Video and Hulu, are gaining ground on Netflix in terms of subscribers, content, and popularity. These services are backed by billion dollar companies with diversified revenue streams, thus do not have to rely solely on subscriptions like Netflix. These factors make these services a threat to Netflix's market domination. In addition, the increasing ease of piracy can attract customers away from

Netflix. In order to maintain/attract customers, the company must constantly obtain and produce new content. This results in a high content expense and many long-term commitments which limits potential profit margins, operational flexibility, and ultimately its liquidity. In addition, because a good portion of its content comes from outside sources and distribution relies on outside partners, Netflix is at times subject to their will and does not always have full autonomy in their decisions. Furthermore, because Netflix is almost completely internet based, potential cyber-attacks could completely devastate the company causing financial loss and loss of trust by consumers and partners.[19]

Chapter 3: Management

Executives

Reed Hastings, Chief Executive Officer, President, Chairman of Cofounder of Netflix, Hastings has to lead the business from the time it was a fledging video company rental company. He has demonstrated that he is incredibly proficient leader that has a vision for the company, and knows how to execute it. A graduate of Stanford University, Hastings has lead Netflix to a billion-dollar industry leader. Hastings has vast experience leading technology companies. He has built a very cohesive business and culture, where the employees are very loyal and eager to help improve Netflix. In addition to his technical prowess and consumer understanding, Hastings is known to be a great leader and corporate manager. He has been lauded for his "innovative management practices" that lead to a culture that is universally respected.[20]

Ted Sarandos, Chief Content Officer- As CCO, Sarandos is responsible for acquiring, adding, and developing, new content for both the online streaming service and the DVD rental service. Joining the company in 2000, Sarandos led the charge from small rental company to Global leader in content and entertainment. Sarandos has revered as an incredibly successful producer that is known and respected in the entertainment world, sitting as the chairman or board member of various film institutes, festivals, and schools. Sarandos also spearheaded the company's dive into critically and commercially acclaimed original programming, that has produced 128 Emmy nominations and 37 wins, 7 Oscar nominations and 1 win and 27 Golden Globe nominations and four wins.[21]

Greg Peters, Chief Product Officer- While known for its content and creative prowess, Netflix also relays the presentation, optimization, and structure of the Netflix system. Peters took over in July 2017, from Neil Hunt who was CPO since 1999. starting in 2008, Peter was International Development Officer for Netflix, helping grow the brand internationally Peters' served as an executive member of digital entertainment software companies like Redhat inc, and Rovi Corporation. Peters helped grow Netflix's global profile, thus he could prove to be a fitting replacement for this important position.[22]

David Wells, Chief Financial Officer – Wells was appointed CFO in 2010 after serving the company in various financials since 2004, developing a deep understanding of the company's financial position, history, and growth. With his MBA from the university of Chicago, Wells has an in-depth business knowledge having been a consultant for the leading professional services firm Deloitte prior to joining Netflix.

Executive Compensation

Netflix has a three-pronged approach to deciding, executive compensation. In deciding the company considers, how much the company would pay to retain the executive, how much would it cost to replace the person, and what the executive would command in the open market.[23] The Compensation Committee of the board of directors determines compensation amounts to the committee based on of market research and comparative data. The Compensation committee partnered with the consulting firm, Compensia, to form a peer group to compare compensation to. The committee then created compensation level and targets based on "percentiles derived from the… group."[24] The peer group was composed of companies that reflected Netflix's position as a media and technology company and included companies like CBS, eBay, and Lions Gate.[25]

After determining the possible compensation, it is divided up amongst three categories: base salary, stock options, and bonuses. The bonuses would only be paid if financial goals set by committee were met in the fiscal year, to ensure that the executive was only getting paid if their performance deserved and weren't getting paid at the expense of the company. Each year the executives receive stock options equivalent to 5% of their possible compensation. The dollar value assigned to the options is only for accounting purposes, as it cannot be received annually as cash compensation unless specified. The company believes tying compensation to equity, "helps align the interest" of executives "with those of the Company's stockholders" and ties compensation to "long-term" company performance. [26] In 2016, Reed Hastings made $900,000 in base salary and $19,050,000 in Stock Options. Greg Peters made $1,000,00 in base salary, $3,275,000 in stock options, and $1, 500,000 in bonuses. Ted Sarandos made $1,000,00 in base salary, $11,800,000 in stock options and a 4,000,000 bonus. David Wells made $2,400,000 in base salary, 1,800,000 in stock options.[27]

Hastings, like most of the employees that work in the Netflix Corporate offices in Los Angeles, does not have an employment contract as he views it as an "inhibitor" to progress and productivity, and that he and the company want employees to work for Netflix because they want to not because they're contractually obligated.[28] For the SEC "Say on Pay" vote, 96% of shareholders voted in approval of the compensation of the executives.[29]

Board of Directors

The Board is composed of 9 individuals, 6 men and 3 women[30], while room for improvement a female perspective is definitely present as they composed one-third of the board. Where the board is incredibly lacking is in their ethnic diversity. Every member of the board is White, as there is no minority representation on the board. Often a problem in the entertainment industry, Netflix's leadership has no racial diversity and thus the views and perspective of a large part of the consumer base can be ignored and not considered. This is a definite area of improvement. The ages of the board member range from 49 to 73, with 6 members of the board in their 50s and 58 being the average age.[31] While older in age relative to the population, Netflix's average age is actually 4 years younger than the average board age of S&P 500 companies which is 62.4.[32] While it is somewhat concerning that a company with a tech-savvy, younger demographic like Netflix's has an older average, it's reassuring that it skews younger in comparison.

The board is incredibly well-experienced in both the entertainment and technology industry, with its members having occupied executive positions who are leaders and innovators in this realm companies such as Disney, Google, Amazon, Microsoft, Facebook, and Viacom. With this experience, the board has a deep and comprehensive knowledge of the industry. In addition, 6 of the members have served on the board for over a decade, with the other 3 joining in 2010.[33] The average tenures of board members in S&P 500 companies is 8.3 years.[34] So Netflix has a notably longer average tenure, this has both positives and negatives. On one hand, the board has an in-depth understanding of Netflix's business and history Yet a fresh perspective could be needed as there is little turnover and change of perspective. For example, "Lead Director"

Jay Hoag was an "early investor" in Netflix, which Netflix admits could "compromise his independence."[35] Another potential problem is that Netflix directors are elected by plurality, not majority.[36] This means the will of the shareholders may not always be reflected in director selection. (This is discussed in depth in the ownership section.)

While The Chairman of the Board, Mr. Hastings, executive/insider from the company, he is the only insider on the board. This speaks well of the independence of the board as it separates company from shareholders. Directors do not receive cash compensation but rather stock options, tying the interest of the board to the interest of the company and shareholders in a tangible way. The board meets 5 times a year. Netflix only disclosed one Related Party Transaction, in which Hastings owns a private jet which is leased to the company and its employees to use from Netflix related business. Netflix reimburses Hastings for travel costs incurred.[37]

Chapter 4: Compliance and Legal Standing

Compliance

Netflix has never had to issue a financial statement restatement, made any late SEC filings, and has gone virtually completely unscathed from criticism of their reporting by analysts. In terms of internal controls, the CEO and CFO attest that their disclosures and procedures provide reasonable assurance that their internal controls over financial reporting are in line with the criteria issued by the SEC. The company assessed the effectiveness of its internal controls reports by using issued standards and deemed their internal controls effective. There have been no changes in internal controls over financial reporting in the last fiscal year. An internal control audit conducted by EY conclude that in their opinion "Netflix, Inc. maintained, in all material respects, effective internal control over financial reporting." These factors can lead to the conclusion that Netflix has had an amazing track record in terms of financial reporting and consistently issues statements that are timely, accurate, precise, and truthful to the best of their abilities. In 2016, $623,000 (10%) of the company's $2,500,000 total audit fees paid to EY were for non-audit services. This is a very low amount of the fees and not an amount that could potentially compromise EY's independence in terms of their audit, as EY would have no reason to place value in consulting fees rather than independent auditing.[38]

Legal Issues

Like most multi-national companies, Netflix has faced legal issues like lawsuits and claims filed against them. The earliest of the prominent legal issues Netflix had was in 2004 when a class-action lawsuit was filed against Netflix claiming false advertising as Netflix had advertised customer receiving DVDs in "one business day", however, in some occasions this was not the case. as some shipments took longer. As a result of the lawsuit, Netflix changed its advertising and terms to acknowledge this.[39] While not admitting to any wrong-doing, Netflix agreed to settle out of court with a $7.3 million payout to customers. In addition, Netflix allowed the suing members to have one month of free-membership and one month of service at higher membership level.[40] This ordeal demonstrated Netflix was responsive to the claims of its customers and sought to reimburse to wronged customers for their perceived shortcomings.

Another prominent legal issue that has plagued Netflix over its history, revolves around its struggles with accessibility of its content to deaf customers. In 2011, a lawsuit was filed against Netflix claiming that Netflix's lack of closed captions on a large portion of its content violated the Americans with Disabilities Act, as it did not provide even services to disabled customers. Despite the lawsuit getting thrown out by a court, Netflix took this issue to heart and added closed captions and subtitle to almost all its content.[41] However, the captions themselves have caused legal trouble for the company. Netflix removed the captions and apologized but did not take any further actions. The company still endures criticism for their captions often being wrong and inconsistently working, and this issue still proves to be a weak point PR-wise for the company. While Netflix, is engaged in other legal battles the company states in its Annual report that "it does not consider the matters to be material either individually or in the aggregate at this time."[42]

Chapter 5: Public Reputation

Community Outreach

Netflix has proven to be a leader in terms of Corporate Social Responsibility Reed Hastings recognized this and in 2009 issued an in-depth presentation/platform separate from its code of ethics that went viral. It described and clearly defined the company's strategy of creating a positive culture for its employees and society and clearly laid out its values. A move that set Netflix apart from its colleagues an earned praise for industry insiders and media. A tentpole of this strategy is to "increase employee freedom as [Netflix] grows." Consequently, Netflix has been praised as a pioneer amongst employee benefits. In 2004, the company implemented "unlimited vacation" for its employees. This means employees can take as much vacation time as they want as long as they clear it with their manager and complete all necessary work before deadlines. This elicited praise from outsiders and media and prompted companies like the Virgin Group to implement similar policies. In the same vein, Netflix announced in August 2015 that they were implementing unlimited Paternal leave for new parent. This moved was once again praised by analysts, and the very next day Microsoft announced a new paternity leave policy similar to Netflix. Wharton School of Business Professor and CSR analyst has said that Netflix, "Raises the bar" in terms of CSR.[43]

In addition, to workplace contributions, Netflix is incredibly involved in the community. Over its history, Netflix has parented with organizations and various charities for a variety of causes such as America's Second Harvest to launch a campaign aimed at ending global hunger. Furthermore, the company gives away scholarships to students and provides financial support to students seeking their Ph.D.[44]

One area the company can improve on is its code of ethics. While Netflix by all accounts has operated ethically and fulfilled its compliance obligations, the Code of Ethics itself is pretty standard amongst companies. While Netflix has publically made a commitment to Ethical behavior in Hastings's 2009 platform, the Code of Ethics could be more substantive to further reinforce this decree. The code covers all major areas of compliance but not that in-depth, totaling 8 paragraphs over its 7 sections. [45]

Controversy

In September 2011, Netflix proposed a company restructure that would officially divide the two services (streaming and rental) of the company into two separate companies that required two separate subscriptions. In addition, it proposed drastically raise prices to $16 a month. The sudden drastic change was announced unexpectedly and not well explained as it announced in a short video from Reed Hastings and an accompanying blog post. This conversion angered fans who believed they were taken advantage of and was mocked by outlets like the Huffington Post and even parodied on Saturday Night Live. The proposed restructure was publically reviled leading to a loss of 800,000 subscribers and in Netflix's stock price plummeted by 75% and its income dropped $209 million to 17 million in 2012. Realizing that this restructuring was universally unpopular, Hastings announced on October 10th, 2011 that it would be completely abandoned.[46] This quick turnaround and decision to listen to the consumer was praised and applaud by analysts who noted Hastings "has shown that he is not insensitive to the demands and grievances of his customers and that he is not afraid to admit, in public, that he has made a mistake"[47] However, they still noted the original decision was a self-inflicted wound that was completely unnecessary.

Another Crisis that is hitting Netflix is currently unfolding. The recognition of the company as a legitimate television network is often credited to its first, popular original program, *House of Cards*, starring Kevin Spacey. The series garnered multiple awards and nominations for Netflix. During filming of the 6th season, on October 29th, Spacey was accused of sexually assaulting a minor in 1986. 12 hours after this accusation was made, Netflix announced that the 6th season of House of Cards would be the last. As more accusations against Spacey came forward, Netflix announced on October 31st they were suspending production of one of its most popular series. Then officially on November 3rd, Netflix announced it was terminating its relationship with Spacey in all capacities.[48] Netflix was praised for its quick decisions making and swift handling of a serious situation concerning sensitive matter.[49] On November 9th, the New York Times broke a story about multiple sexual assaults allegations against comedian Louis C.K., which he later confirmed The next day, Netflix officially, swiftly canceled his upcoming Netflix special. Furthermore, on December 5th, 2017, Netflix terminated their relationship with the star of their original comedy series *The Ranch*, after multiple rape allegations were levied against him.[50] These actions helped establish and solidify the company's no tolerance stance on sexual assault.[51]

Chapter 6: Stockholder/Ownership Breakdown

Netflix is predominately owned by institutional investors, who own 84.28% of the company. Capital Research global investors own 46,909,261 shares (12.86%), Vanguard Group Inc. own 28,450, 205 shares (7.88%), and Blackrock Inc. own 25, 492, 439 shares. (6.9%). The two biggest pension investors are the California Public Employees' Retirement System aka CalPERS (842, 438 shares) and the New York City Pension Funds (1,173, 000 shares). In terms of individual owners, Reed Hastings owns 11,800,000 (1.9%) shares, Director Jay Hoag owns 6,400,000 shares, and former Chief Product Officer Neil Hunt owns 1,300,000 shares.[52] In terms of individual owners, Reed Hastings owns the most shares. (See figure 3 for breakdown.) In terms of shareholder activism, in October 2012, famed activist investor Carl Icahn bought 10% of Netflix shares[53] but did not push any specific agenda, and sold his last shares in 2015.[54]

While most recent shareholder proposals are standard fare, there has been a recurring theme amongst them that has proven to be divisive proposals. The major points of contention are that directors do not need to be elected by a majority and that shareholders do not have proxy access, thus they cannot put their own candidates up for election. This essentially allows Netflix to name their directors and keep them on the board at its discretion regardless of shareholders' opinion. This has led growing shareholder unrest. Shareholders have proposed and approved board changes 17 times in the past 6 years. Despite these countless proposals Netflix has rejected and disregarded them. Various changes in the director election process, such as needing a majority of votes and annual elections, were voted for with overwhelming majority yet still ignored. This fact is highlighted by the fact that two directors have not received a majority vote over the past 4 years yet remained on the board. This has become such an issue that "Institutional Shareholder Services, which advises investment funds on corporate elections, gives Netflix its lowest score in a corporate governance ranking."[55]

Two of the biggest critics of this treatment of shareholders are CalPERS and the New York State Pension funds, the two biggest pension investors in the company. In 2016, the investors offered a proposal to allow shareholders proxy access. In their opposing statement Netflix stressed the board has a fiduciary duty to stockholders, that shareholders themselves do not have. Thus, these stockholders could nominate directors who advance their own specific agenda without regard to the best interest of the Company and its stockholders… including independence, expertise, and diversity." Despite this opposing statement, shareholders voted 71% in favor of this proposal. Netflix acknowledged the vote but did not grant proxy access. [56]

Chapter 7: Ratio Analysis

*All ratios were calculated by the investment research website Morningstar inc. and reculated by myself.

Ratio Table[57]

Netflix				
Ratio	2013	2014	2015	2016
Current Ratio	1.4	1.47	1.54	1.25
Total Asset Turnover	0.81	0.78	0.66	0.74
Debt Ratio	75%	73%	78%	68%
Debit to Equity Ratio	1.42	1.48	1.54	1.26
Profit Margin	2.56%	4.84%	1.80%	2.11%
Return on Assets	2.08%	3.78%	1.20%	1.37%
Dividend Yield	0	0	0	0
P/E Ration	215.17	100.63	329.54	456.51

Liquidity and Efficiency Ratios

Netflix Current Ratio

2013	2014	2015	2016
1.40	1.47	1.54	1.25

Netflix's current ratio has remained constant and has slowly increased over the past four years, indicating that the company is effectively managing its assets and liabilities. It also indicates that the company will not run into any debt or bankruptcy issue in the near future. The company's ratio being over 1 indicates that Netflix's short-term assets are very liquid, and that its assets are substantially greater than their liabilities. Netflix would be able to pay off any short-term debt that would come due The current ratio being under 2 shows that the company is investing assets well, and not simply retaining them, demonstrating that the investment and operation practices of the company are working very efficiently.

Netflix Asset Turnover Ratio

2013	2014	2015	2016
0.81	0.78	0.66	0.74

To understand if Netflix is efficiently using its assets to generate revenue it most first be compared to its average market rate. The average Asset Turnover rate for the Telecommunications industry (the closest market sector Netflix can be compared to) is anywhere from .60 to .8.[58] Netflix's ratio has remained between this range indicating it is normal for its market. It dropped by .1 from 2013 to 2015, which could be taken as a potential warning sign. Though, the consistent drop throughout the past three years could be from Netflix's increase in creating and acquiring new content, as its increases in assets may have not had enough time to show their return. The almost .1 increase from 2015 to 2016 supports this theory. The majorities of Netflix's assets stem from expensive content and thus will never have the small asset/ high sale relationship that retailer stores and fast food restaurants have. Thus Netflix Asset Turnover ratio indicates that Netflix is efficiently using its assets to generate revenue.

Solvency Ratios

Netflix Debt Ratio

2013	2014	2015	2016
0.75 (75%)	0 .74 (74%)	0.78(78%)	0.68(68%)

Netflix's debt ratio had remained constant throughout the past three years only fluctuating by small increments of 2% to 3% respectively from 2013 to 2016. Netflix's Debit ratio has hovered around 75% meaning that 75% of its company's assets are financed by debt. This indicates that the company is very leveraged which in turns mean that it has a higher financial risk. The high debt ratio shows that Netflix is a risky company as it could have an overreliance on debt. However, debt can be beneficial has many companies find ways to use debt as tool to help grow and expand the company. Thus since Netflix has taken on an aggressive growth and expansion plan, these numbers could be an indication of its aggressive expansion, and not a complacent overreliance on debt as a way of funding. The large 10% from 2015 to 2016 could be a sign that Netflix realizes this risk and has shifted away from this strategy. Furthermore, because of Netflix's increase in revenue and net income, the company is becoming more financially self-sufficient.

Netflix Debt to Equity Ratio

2013	**2014**	**2015**	**2016**
3.05 (305%)	2.79 (279%)	3.58 (358%)	1.26 (126%)

Like the Debt Ratio, the Debt to Equity Ratio indicates that Netflix is aggressively using debt to gain leverage demonstrated by the obscenely high ratios that. This reinforces the notion that Netflix, currently rapidly expanding and growing, is financing said expansion with a debt. The 79% increase falls in line as Netflix sought to expand at a greater pace from 2014 to 2015, in turn meaning they would rely on heavily on outside funding for the many projects and content they are seeking to create. Because the company is taking on a tremendous amount of debt, around 300% in comparison to the value of its stock, it reaffirms that while the company is effectively growing itself, it is putting itself at incredibly high risk. The 232% decrease from 2015 to 2016 is an excellent sign that the company is shifting away from its efficient, yet risky financing strategy.

Profitability Ratios

Netflix Profit Margin

2013	2014	2015	2016
0.0256 (2.56%)	0.0484 (4.84%)	0.018(1.8%)	0.0211(2.11%)

At first glance, the fact that Netflix is generating 4.374 Billion, 5.504 Billion, and 6.779 Billion while only having a profit margin in the low single digits is jarring. The Profit margin increased over 2% from 2013 to 2014 before dropping down 3% in the next year, indicating a drop in Net Income as sales increased. 2016 represented a small .3% increase. While the company was pulling in billions of dollars in revenue, it was only retaining 2% of its revenue in 2013, 4.8% in 2014, 1.8% in 2015, and 2.11% in 2016 alarmingly low numbers. Netflix is generating an incredible amount of money but not actually retaining the majority. While it brings in billions of revenue it only manages to make a profit in the hundreds of *millions*. While $112,403,000 in 2013, $266,799,000 in 2014, and $122,641,000 in 2015, and $186,680,000 in 2016 are still impressive numbers that demonstrates great financial health, the profit margin can definitely be improved.

The reason for this low profit margin is related to the incredibly high cost of Revenue. Netflix is bringing in an incredible amount of revenue, the cost of that revenue is almost equally as high. Cost of Revenue was 71.26% of the total Revenue in 2013, 68.17% in 2014, 67.73% in 2015, and 56% in 2017. The cost of acquiring, licensing, and distributing these TV shows and Movies is incredibly high, thus even though millions of people are subscribing and renting the profit will never be as large as the revenue. While Netflix can continue to obtain and distribute more content and attract more subscribers, it will still have to pay for the content and pay to distribute it, meaning until subscriber numbers and the consequent revenue they generate far outweighs the billions it cost for content then the profit margin will continue to remain in the lower single digits, though the consistent decrease in cost of revenue is a promising sign.

This is something that Netflix has realized and in fact it is this realization that has lead to their aggressive expansion and foray into original content. Since, original content costs less to produce and the company does not have to pay distribution and licensing fees, the total costs of the Company will decrease. A decrease in total costs without sacrificing revenue means a greater profit for the company, which in turn means a higher profit margin. Since this is true, Netflix has expanded into original content not only to increase popularity but as a way to lower costs and increase profit margins. This tactic has already proven beneficial as the Cost of Revenue relative to total revenue has slowly, but steadily decreased 3% from 2013 to 2014 and 1% from 2014 to 2015. The company's expansion also explains why the profit margin decreased from 2014 to 2015. Because of an new initiative of original content and rapid expansion, costs such as marketing and technology and development also increased an average of 1% per year leading to higher costs without seeing the revenue the expansion generated.

Netflix Return on Assets

2013	2014	2015	2016
0.0208 (2.08%)	0.0378(3.78%)	0.0120(1.20%)	0.0137(1.37%)

Much like its profit margin, Netflix's low single digit return on assets stems from the Cost of obtaining the company's assets and the low net income in comparison. While at first glance, it seems that the company is very inefficient using its earnings to generate assets, yet it is simply because of the high cost of obtaining content. Revenue shows the company is generating earnings using assets rather efficiently, yet simply does not have a low enough price and consequently net income for the ratio to approach the ideal amount.

Market Prospects

Netflix P/E Ratio

2013	2014	2015	2016
215.17	100.63	329.54	456.51

The incredibly high P/E Ratio demonstrates that Investors are expecting higher earnings growth in the future, which would fall in line with Netflix's expansion plans. The P/E ratio serves to show "the dollar amount investor can expect to invest in a company in order to receive one dollar of the company's earnings."[59] Meaning that in 2013 an investor would need to invest $215 dollars in the company in order to get $1 dollar in return. Because they are so high, it signifies that investors realize the potential growth the company will go through and are willing to pay a large amount. The fluctuation between 2013 and 2014 (a drop of $100) could be because the company was undervalued in 2014 or performing much better than past trends indicated it would. The spikes (an increase of $229 from 2014 to 2015 and $127 from 2015 to 2016 respectively) could be because Netflix made it known and began its rapid expansion and growth, making investors aware of the higher future growth.

Chapter 8: Key Financial Statement Accounts Analysis

*All financial calculations and account balances were derived/acquired from the company's financial statements found on the Netflix Company website and Yahoo Finance.[60][61]

Total Revenue

2013	2014	2015	2016
$4,374,562,000	$5,504,656,000	$6,779,511,000	$8,830,000,000

Netflix's total revenue increased by $1,130,094,000(25%) from 2013 to 2014 $1,274,855,000 (23%) from 2014 to 2015 and $2,050,489,000(30%) demonstrating incredible revenue growth. The company's continued aggressive expansion, continued growth, and virtual domination of the Market has led to a consistent 23-30% increase in revenue for the past three years. contributing factor is Netflix's increasing popularity and place as a cultural touchstone, leading to an increase of around 7 million subscribers per year leading to increasing revenue. In addition, in 2014 Netflix increased its subscription fee for new subscribers by 2 dollars per subscription. This raise in fees in addition to increasing popularity, has led to consistent, substantial revenue increases, which is a trend that seems to be continuing.

Net Income

2013	2014	2015	2016
$112,403,000	$266,799,000	$122,641,000	$186,680,000

Netflix's net income increased by 154,396,000 (137%) from 2013 to 2014 and decreased -144,158,000 (-54%) and 64,039,000(52%) These drop from 2014 to 2015 seems to be in incredible contrast to each other, as the company proceeded to more than double its income from 2013 to 2014 then seemingly experience a sharp drop seeing its income decline by more than 50% of its total in 2014 before rebounding 52% in 2016. Analysis of past financial records shows that these numbers may be exaggerated. As previously touched upon in “Chapter 5”, in 2011, Netflix proposed a company restructure that would was reviled by customers and investors and thus its stocks and revenues plummeted. When the proposed restructure was abandoned and consumer trust regained the company had a steady growth in income, potentially leading to a jump a seemingly higher than usual net income. In addition, in 2014 Netflix launched an initiative to create original programming including documentaries, movies, and televisions.[62] The creation of this new branch lead to increased costs for marketing, production, distribution, and licensing resulting in a substantially lower net income in 2015, due to higher costs before the new branch could bring in revenue to cover the costs. Thus the dramatic increase from 2013 to 2014 was likely the result of a financial rebound and the decrease from 2014 to 2015 a result of the company being healthy enough to branch out into a new market.

Total Assets

2013	2014	2015	2016
5,404,025,000	7,042,500,000	10,202,871,000	13,586, 610,000

Total Liabilities

2013	2014	2015	2016
4,070,464,000	5,184,792,000	7,979,445,000	10,906,810,000

Netflix’s total assets increased by $1,638,475,000 (30%) from 2013 to 2014 $3,160,371,000 (45%) from 2014 to 2015, and $3,383,739,000(33%) in 2015 to 2016. As Netflix continues to grow its becomes more aggressive in its expansion, their efforts and results are reflected in their assets. The asset’s steady increase is reflection of Netflix’s continuing acquisition of new content and creation of new content, as nearly 70% of its assets are non-current and current assets. In addition to content, Netflix's growth has resulted in a steady increase in Cash and Cash equivalents, which make up a relatively sizable portion of the assets. (Anywhere from 11%-17% of total assets. These factors have led to a sizable and steady growth in Assets

Netflix's total liabilities increased $1,114,328,000 (27%) from 2013 to 2014, $2,794,653,000 (53%) from 2014 to 2015 and $2,927,365,00(36%) from 2015 to 2016.While the company's continued growth, mainly its acquisition and creation of content, has led to an increase in asset and revenues in has also lead to an increase in liabilities. The company's main revenue stream and product generates a great deal of revenue, yet also costs a great deal to produce, acquire, and market; thus, as assets and revenue increase, so to will liabilities. Just as it was for assets, current and noncurrent content liabilities, such as licensing and distribution fee, account for the majority of the company's liabilities. (Anywhere from 76% to 80% of the company's total liabilities.)

Stock Price at Year End*

2013	**2014**	**2015**	**2016**
368.17	341.61	114.38	122.80

* Netflix executed a 7 for 1 stock split on July 14, 2015.

Stock Price

Due to the company's relatively young age, incredible growth projections, and virtual monopoly on its respective market Netflix is viewed as very valuable stock. The company only issues common stock and does not pay dividends. Before 2015, Netflix's stock price routinely hovered around the lower $300 price range. (An outlier being late 2011 into 2012 where the company restructure lead to the stock price plummeting 75%.) At first glance, the companies decline in stock price by $27 from 2013 to 2014 seems fairly normal, yet its $227.23 drop seems incredibly alarming. However, the reason for the apparent dramatic drop is fairly simple. Netflix executed a 7 for 1 stock split on July 14, 2015. This meant that the company gave shareholders six more shares of stock that in turn lowered the price.

Cash and Cash Equivalents

Cash and Cash equivalents rose $508,643,000 (84%) from 2013 to 2014 and $695,722,000 (62%) before dropping $342,754,000(18%) in 2016. The company saw this account continue to increase for a 3 year period from 2013 to 2015 before leveling off in 2016, demonstrating strong financial health and increased liquidity, which speaks well for its short-term financial health. In addition, this account was the largest non-content asset account, making up 11.19% in 2013, 15.81% in 2014, 17.73%, in 2015, and 10.8% in 2016. The constant growth reflects the growth in revenue. The substantial growth reflects Netflix's growth strategy and its increased leverage position.

Current and Non-Current Content Assets

these to accounts make up the vast majority of the company's assets, as content acts as the company's main product and thus the majority of its assets. The company's current content assets made up 32.33% of the company's assets in 2013, 30.76% in 2014, 28.48% in 2015, and 27.4% in 2016. The non-current assets made up 38.69% in 2013, 39.38% in 2014, 42.27% in 2015, and 53.54% in 2016. On average, the content assets made up around 70% of the company's total assets, demonstrating the company's reliance on its content as its main source of revenue. While both accounts increased steadily from 2013 to 2014, there was a dramatic increase from 2014 to 2015. (Current assets increased 739,864,000 (34.15%) while Non-current increased 1,539,491(55.51%)

This increase may be attributed to Netflix's aggressive growth strategy that includes acquiring content and producing and creating its own original content. There was were relatively minor increase in these accounts from 2015 to 2016.

Current Content Liabilities

Much like the Company's content assets, Netflix's current content liabilities make up the majority its of liabilities. The Current content liabilities made up 32.86% of the company's total liabilities in 2013, 30.06% in 2014 and 27.34% in 2015 and 33.30% in 2016. Liabilities like licensing and distribution fees and other payments for acquiring content make up a large part of the liabilities, thus when more content is acquired the content liabilities will go up reflected by the steady growth of the total amount of liabilities. However, unlike assets the total percent of liabilities that content liabilities make up has decreased over the past 4 years. (Around 2% each year.) This decrease maybe attributed the Company's foray into original content. As Netflix produces its own original programming, it does not need to acquire as much content, thus licensing and distribution fees would decrease leading to a decrease in percent. While the more content means more fees thus higher liabilities, the more original content lowers the ratio of current liabilities even if the total amount rises.

Long-term Debt

The long-term debt of the company increased steadily over the past three years, increasing by $230,242,000 (29%) from 2013 to 2014, 450,528,000 (28.58%) from 2014 to 2015 and 992,949,000(41.87%) from 2015 to 2016. As Netflix sought to expand aggressively over the past three years, it has taken on my debt. Many companies take on debt as a way to get leverage that in turn can be used to help grow and expand the company. Thus Netflix's increase in debt could be due to their rapid expansion.

Cost of Revenue

While Netflix brings in a large amount of Revenue, the cost of this revenue is extremely high. Because the majority of Netflix's revenue is built around the subscription model and people subscribe and remain subscribe because of the content, the company must continue to acquire new content. Acquiring and distributing content is not cheap as licensing and distribution fees and acquisition itself results in billions of dollars in cost. For this reason, Cost of Revenue relative to revenue an incredibly high amount, 71.26% in 2013, 68.17% in 201467.73% in 2015 and 68.28% in 2016. This leads to a relatively small profit margin and net income. Netflix realizes the difficulty of turning a relatively profit on its current business model and has sought to make more original programming, in order to lower licensing fees. The biggest cost of revenue for the streaming segments are "content expenses" which are expenses directly derived from acquiring and licensing content and production expenses relating to original programming. Because of an aggressive growth strategy and increase in original programming the content expenses, have increased drastically.

Chapter 9: Conclusion

After analysis, I believe that Netflix is in both excellent operational and financial health and would deem it a worthy investment. In terms, Netflix is incredibly popular and is growing at a rapid rate, resulting in incredibly high revenues in the billions, an astounding figure for a relatively young company. The company is valued highly on the stock market and has investors have shown tremendous confidence in the company's future and growth as a whole. The company's main business revolves around the acquisition, distribution, and production of content, leading to high content assets and liabilities. However, because these fees and content are so expensive, it results incredibly high costs of revenue and in turn a relatively low net income for a company generating billions in revenue. Thus the company does not have profit margin and is not that profitable as a business. The company has realized this and has launched an aggressive expansion and growth initiate that involves creating and producing its own original content. This foray has lowered cost of revenue, but the extra expenses that stem launching this initiative are just starting to be negated by the revenue it is generating and the costs it is lower.

Because it is rapidly growing, the company is taking on a good amount of debt as a way to gain leverage and consequently expand. This has resulted in the company appearing to be at a high risk, however this is just a consequence of the company's rapid expansion and growth. Because of this the company has very liquid assets, and a very promising short-term future. Netflix is effectively using its assets and investments to generate revenue, as best it can with high cost of revenue. In comparison to other Internet streaming companies like Pandora and Cable providers like Comcast, Netflix is either achieving or exceeding market expectations or averages, cementing its place as a company on the rise. Netflix is an incredibly well-run company that is in great financial health and is effectively and efficiently expanding and growing. Netflix is an incredibly financially healthy company with an incredibly positive future.

The company has become a billion-dollar company in just over two decades, while simultaneously changing the entertainment industry and becoming an online innovator. Due to the nature of its business, the company does not have a large net income, but an increase in original content is leading to a great profit margin. The financials of the company are healthy and incredibly encouraging, and its financial reporting and compliance track record raises no cause for concern. While the risk of new competitors and reliance on subscriptions are concerning, the company's foray into original content has taken Netflix to the next level. Netflix is only growing and does not look like it will stop anytime soon. The company is in great hands, as management and the board are very experienced and knowledgeable and have proven they can continue to grow the company.

Furthermore, Netflix management has handled the company expertly in times of crisis and legal trouble always got it back on track, even if some crises have been self-inflicted. Through its action, the management and the board has demonstrated a concern and willingness to listen to its customer base which is incredibly important in a company that relies on subscriptions. Additionally, the company has proven to be a CSR leader and pioneer in its industries when it comes to culture, treatment of employees, and community outreach. This speaks well for the future.

However, there is one major of concern. By investing, shareholders should realize that Netflix often ignores the shareholder's opinion concerning the board. This is troubling considering of shareholder's monetary investment often does not result in their voice being heard. Despite this, the board and management has proven that at they do indeed have the company's and ultimately the shareholder's best interest in mind, and have successfully led the company to the new heights. Their expert leadership and management earned them the benefit of the doubt. This is an area to keep an eye if financial performance begins to falter or if the board truly begins to abuse its power. Ultimately, Netflix is an incredibly well-run company that is in great financial health and is efficiently expanding and growing and thus has an extremely positive future.

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