Netflix (NASDAQ: NFLX)

David Gardner | May 1, 2003

CURRENT PRICE: NFLX $ 471.20 ↑ $ 3.16 (0.7%) [illegible]

If you can consistently make life more convenient for your customers, you're on my short list of potential investments.

Amazon.com, **AOL Time Warner**, **eBay**, **Martha Stewart** --each is a very strong consumer brand, and each got that way by providing legions of mainstream customers something good, easier and cheaper. Each, by the way, has also provided nice returns for *Motley Fool Stock Advisor* subscribers.

Netflix (NASDAQ: NFLX), my selection this month, perfectly embodies this obsession with convenience. Think of Netflix as Blockbuster Video for couch potatoes. Wait a minute--you thought renting videos and DVDs at Blockbuster was about as couch potato as it gets? Not compared to Netflix. With its DVD rental service by mail, you don't ever have to get off your couch.

NETFLIX, INC. IN 1 MINUTE

What It Does

Netflix is one of the top names in video streaming, both domestically and around the world.

Company Guide

- **Industry:** Entertainment
- **Asset Class:** Large
- **Region:** US
- **Price on June 21, 2020:** $ 468.04

Key Data

- **Headquarters:** Los Gatos, CA, US
- **Sector:** Unknown
- **Market Cap:** $518M

Add NFLX to Your Favorites

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And no more late fees.

Netflix boasts a library of 13,500 DVD titles, about five times the inventory of your typical video rental store. With Netflix, you order up to three DVDs; Netflix mails them to you, and you watch them when you like. Then, whenever you decide to send one back to Netflix in its enclosed pre-addressed, postage-paid mailer, you select another in its place.

That's the service, for $20 a month (actually, Netflix now offers four levels of memberships from $14 to $40 per month). Over a million people are already using Netflix, and Blockbuster and Wal-Mart are scrambling to compete. Reminds me of how Wal-Mart scrambled (too late) to compete with Amazon.com. In other words, good luck. No one's going to catch Netflix at this profitable business model.

Consider this from a Blockbuster spokeswoman just this week: "Frankly, we see online subscriptions as a niche business. We think the real win-win will be a combination of an online and in-store service."

Frankly, I think you're wrong, but just keep telling yourself that. The longer you and others continue to underestimate Netflix, the better off we'll be.

But Does It Pay?

For Q1, Netflix reported sales of $56 million, 82% ahead of the same (year ago) quarter last year and 23% higher than the previous quarter (sequentially, as they say on the Street). The company's subscription business, probably my favorite type of business model (sound familiar, Tom?), served just over one million customers.

For the quarter, the company's average monthly churn, which includes both paying and free-trial customers who elect not to pay, was 5.8%. That represents a decline of 20% from 7.2% a year ago. More importantly, it's a new record low.

Despite improvements in revenues and churn, Netflix is still working toward profitability, and lost money for the quarter. Does this mean that Netflix is one of those ever-unprofitable dot-coms?

Nay, dear Fool. Despite the net loss, the cash flow provided by the company's operating activities tipped the scales at $12.8 million for the quarter and $46.4 million for the past 12 months.

All This and More

Here's the way I see it: The stock trades at $21.50 as I write. That puts the market cap at around $500 million. The company has a bit more than $100 million in the bank, so net of cash, the business itself is valued at around $400 million.

That's just four hundred million dollars for a *convenience-providing* business that has a developing consumer brand, over a million customers already, a subscription business model and increasing cash flows. Plus--and and I can't stress this too much--the company's managed by someone I respect a great deal, CEO Reed Hastings.

Moreover, the perceived threat posed by its (slow-on-the-uptake) competition has kept a lid on the stock price. And come to think of it, if and when the competition ever does get on the ball, that might not be such a bad thing. In Hastings' own words, "Increased competition will drive consumer interest in the category overall."

Remember, Tom, we heard much the same thing from Whole Foods CEO John Mackey regarding the much ballyhooed threat of competition from the big chain grocers. I think they're both right.

And keep this in mind: Reed Hastings is no rookie. He really impressed us on our NPR radio show, and his first California start-up, Pure Altria Software, was a winner. In fact, it was ultimately scooped up by Rational Software for around $750 million.

Call That a Bargain

Again, this is a company that has money in the bank, a sound business model, solid leadership, and is working toward profitability.

More importantly, I think Netflix will generate about $60 million of cash flow this year. If I'm right, you're paying something like 7X this year's cash flow for Netflix today.

I'd call that a bargain and a likely double over the next three years. Take a look.

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