

Holland Views: SCA & Netflix– Price \$340 Mcap \$154bn

The Discovery Channel

$$\textit{Potential Value} = [\textit{market scale}] * [\textit{power}]^1$$

The more we have looked at the strength of Netflix’s market position the more we like it. Its network scale and now owned content are tangible advantages. However, we note many other unseen intangible ones that we think just as important. It offers customers great value for money in a media sector known more for its price gouging and contract tie-ins. The success of its in-house produced content in such a short period of time is remarkable. As is the fact that this IP is now evident in wider global culture (e.g. Chess set sales and Kate Bush’s revival). This suggests Netflix has both a strong in-house ability to identify and produce quality content. Also, that its share of mind is even higher than its market share. What was once a counter-positioning upstart has morphed into a powerful, hard to catch, consumer friendly Scale Economy leader.

Importantly we also think the company is about to enter a “discovery” phase as to its pricing power and its true current customer value. This will come via the combination of its new rules on password sharing and an offering of advertising backed subscription. Companies who always maximise price, likely see jumps in churn when they make such enforcements. We think Netflix is poised to experience the opposite and we are excited about what value these coming changes might reveal.

Turning the pages

Holland Advisors’ approach to investment analysis has long been anchored in the abbreviation WWW i.e., What Would Warren do... if he were looking at this company, or the universe of companies we are addressing? In the last c.5y we are more influenced by Charlie Munger. Charlie’s use of Mental Models to identify powerful businesses/models is something that resonated strongly with us. Having spent decades as sector analysts and often not seeing the wood for the trees, we love the ability these models give us to distinguish powerful, sustainable growth models from mere noise. We are always attracted to texts that enable us to develop these skills further. Jim Collins’ [Good to Great](#) and [Built to Last](#) helped us a lot, as of course did Phil Fisher’s [Common stocks and uncommon profits](#). With such books and Charlie’s help we started to find business models and companies that we thought powerful but underestimated. The EDLP/flywheel model is our often-used example. Upon reading Nick Sleep’s articulation of these companies as “Scale Economy Shared” models we realised his description far better encapsulated what these companies were doing. As such we have shamelessly copied/cloned it.

¹ Extracted from 7 Powers by Hamilton Helmer

Owner managers

The other driver of what we are seeking to find is clearly aligned owner managers. This is mostly due to the invention, innovation and often-times brilliance they bring to their companies. As a result, we have devoured the biographies of Charles Schwab, Jeff Bezos and Michael O’Leary amongst others. A book that helped us better collate our thinking on owner managers was [The Founder’s Mentality](#) by James Allen and Chris Zook. An introduction to which can be seen [here](#).

Seven Powers

Last year’s we discovered [7 Powers](#) by Hamilton Helmer. In the same way that Owners Mentality helped us put a framework around the traits we had found recurring with the owner managers we encountered, 7 Powers did the same with our business model thinking. It looks at Sustainable Competitive Advantages (SCA) under the moniker of ‘Power’ and how that power can be derived in different ways. Some of its content is not new, but the way it structures and looks at the interaction of different SCA’s is very useful.

Both books have been great additions to our arsenal. As we search for an ever-better stock selection net to catch our fish in, we find ourselves referring back to these texts often. We cannot recommend them enough.

Serendipity& generosity

Before discussing Netflix in the context of this reading/approach we want to give out a sincere ‘Thank you’. There are so many stock ideas to look at and so many companies that touch our lives day to day. As such we all have a little knowledge of many businesses, but that does not mean we have properly considered them as potential investments. Whilst the textbooks above and c.30y in the job give a good framework for what to look for, they don’t tell you where to fish. Something needs to tip you over from knowing what a company does to really seeking to understand it. That something in your authors case came from a chance meeting with a bright young analyst. He had read a little of Holland’s work and was insistent that we should look at Netflix, believing that it, and its founder were the type of business/managers we seek. From the reading and reflections we have done so far, we think his observation correct. So: *“Thank you, Analyst X”*

The Path to Power

The reflections that follow on Netflix are similar to those we made on Amazon last year. In truth we can achieve very little edge over other 52(!) analysts looking at Netflix in analysis of such companies’ day to day operations. Instead, what interests us is a recognition of a powerful model if we have seen it before.

In **Amazon’s** case our research on the company found us quickly feeling as if Jim Collins’ work on how to build a great company was coming to life in front of our eyes. In **Netflix’s** case the more we read the more we reflected on traits that we remembered reading in 7 Powers last summer. As a result, we decided to read it again. Only on doing so, did we remember that the preamble for the book was written by Reed Hastings! Indeed, Helmer also uses many Netflix examples throughout the book.

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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