LIBERA UNIVERSITÀ INTERNAZIONALE DEGLI STUDI SOCIALI

Netflix: Financial Position Analysis and Evolution in the Market for Online Streaming Services

Department of Economics and Business

Chair of Introduction to Business Economics

SUPERVISOR

Prof. Saverio Bozzolan

CANDIDATE

Pierfrancesco Mazzolini

174501

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"Do not follow where the path may lead. Go instead where there is no path and leave a trail."

Muriel Strode

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Introduction

Throughout the beginning of the 21^{st} century, as our world was experiencing a strong evolution in technology, new consumer trends were starting to expand in the broadcasting industry. Coming from an era were services in the television sector were very broad and limited, the latest implementation of online streaming services, has since permitted customers to benefit from a wide range of available commodities. As the television industry faces new innovations, industry incumbents encounter new challenges, and already established competitors are displaced. In consequence, the online video streaming service is considered a disruptive innovation to the conventional TV system.

Several enterprises however, have been able to distinct themselves for their capacity to react to market changes and to the transformations caused by the many innovations introduced at the time. Netflix presents a consolidated example of this firms who have been able to positively react to the market alterations. This company has encountered several structural modifications in order to adapt to the possibilities that the “new” market had to offer. Netflix was originally created as an online DVD rental service, for then successfully establishing itself in the market for over-the-top (OTT) services. The company’s successful incorporation in the market and the growing popularity of the service has permitted Netflix to realize its own original products. Some popular examples of Netflix’s originals are the TV-shows *House of Cards, Narcos, and Orange is the new black.*

The purpose of this thesis is to investigate, from a business and financial point of view, the progress that the online television industry has had in the last decade. Specifically, the main focus of this paper will be emphasized on Netflix, which in the last few years has been the leader in this specific sector. The company has successfully entered the television industry by combining complementary technologies, reinventing the home video rental model, and by undertaking costumer needs. By centralizing Netflix as the core of the discussion, the thesis will identify the evolution of a specific business in the market, and the dynamics of a disruptive innovation. All this will be backed up by both quantitative (empirical) and qualitative data, showing a balance sheet analysis of the company during the last three years. The thesis will also include primary sources from newspapers and journal articles discussing the structure of the company, and first hand empirical data taken by the company’s website. The dissertation will also present a deeper intuition (from a financial point of view) of the company, comparing the financial position of Netflix with its main competitors, specifically Amazon (Amazon Prime Video).

Overall, the thesis will be divided into three different chapters. The first chapter will expose the history of Netflix, and will analyze the business model of the company taking into consideration three main questions: *What are Netflix's reasons for success? In what does Netflix differ from its competitors?* And finally, *what opportunities can the company seek to improve in the future*? The second chapter will cover a financial analysis of the company. It will show a balance sheet and financial statement analysis, evaluating the well-established financial position of the company during the last several years. The third chapter will evaluate an analogous financial analysis of one of Netflix's main competitor Amazon, with its latest service Amazon instant video. With the final results and data at hand, the chapter will conclude with a comparison between both companies evolution in the market during the last three years. In the conclusion, the thesis summarizes all the influencing factors, which played an important role in the evolution of Netflix in the market of online streaming TV. It will also be discussed the disruptive nature of the company, and an ex-post hypothesis will be given on how the company can improve, and on the characteristics which permit consumers to foresee Netflix as an important service that will satisfy their expectations for many more years.

Chapter 1: Company description

1.1 Netflix History

Reed Hastings, Mark Randolph and Mitch Lowe founded Netflix in 1997 as a movie-rental service, and as an answer to the inconvenient problems of movie rentals late fees[1]. The initial idea came to Hastings when receiving a $40 fine for returning an overdue copy of the movie Apollo 13. The basic idea behind Netflix was that of creating a movie-by mail-rental service that would benefit from the new context that was born with the development of the Internet. Clients could choose which DVD's to rent within the company's online platform from which they had previously subscribed. The platform, which was officially launched in April 1998, allowed customers to access a vast film catalogue, divided into sections by genre, actors, or producers. The chosen DVD's where then sent via mail directly to the clients house the day after they where being selected. The number of DVD's available for renting where determined by type of subscription. The subscriptions had several variations, but the main one was the one with a cost of $19,95/month, which permitted users to rent up to 3 DVD's at a time.

At the time (beginning of 21st Century) the market for movie renting wasn't very vast, in fact the company could benefit from a rapid success due to little competition between businesses that rendered the service. Hastings stated, *"We were targeting people who just bought DVD players. At the time our goal was just to get our coupon in the box. We didn't have too much competition. The market was underserved, and stores didn't carry wide selection of DVDs at the time*"[2]. In fact in no time, the idea of focalizing on the market of DVDs was revealed to be the right strategic road to take. DVD players became the most adopted technology at the time. In the US throughout the 1990s, the presence of DVD players in houses was used by approximately 5% of the population. Within one-year time (beginning of year 2000) this number increased to 13%, to finally increase to 37% users in 2002.[3] The following chart (Fig.1) shows the periodic increase in Netflix's subscriptions from the year 1999 to 2003.

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[1] Legend has it that Hastings found an old, forgotten rental copy of *Apollo 13* in his closet that had accumulated somewhere in the neighborhood of $40 or $50 in fees.

[2] Willy Shih, Stephen Kaufman, and David Spinola, ―Netflix,‖ HBS No. 9-607-138 (Boston: Harvard Business School Publishing, 2009), p.3

[3] http://www.washingtontimes.com/news/2003/jun/20/20030620-113258-1104r/

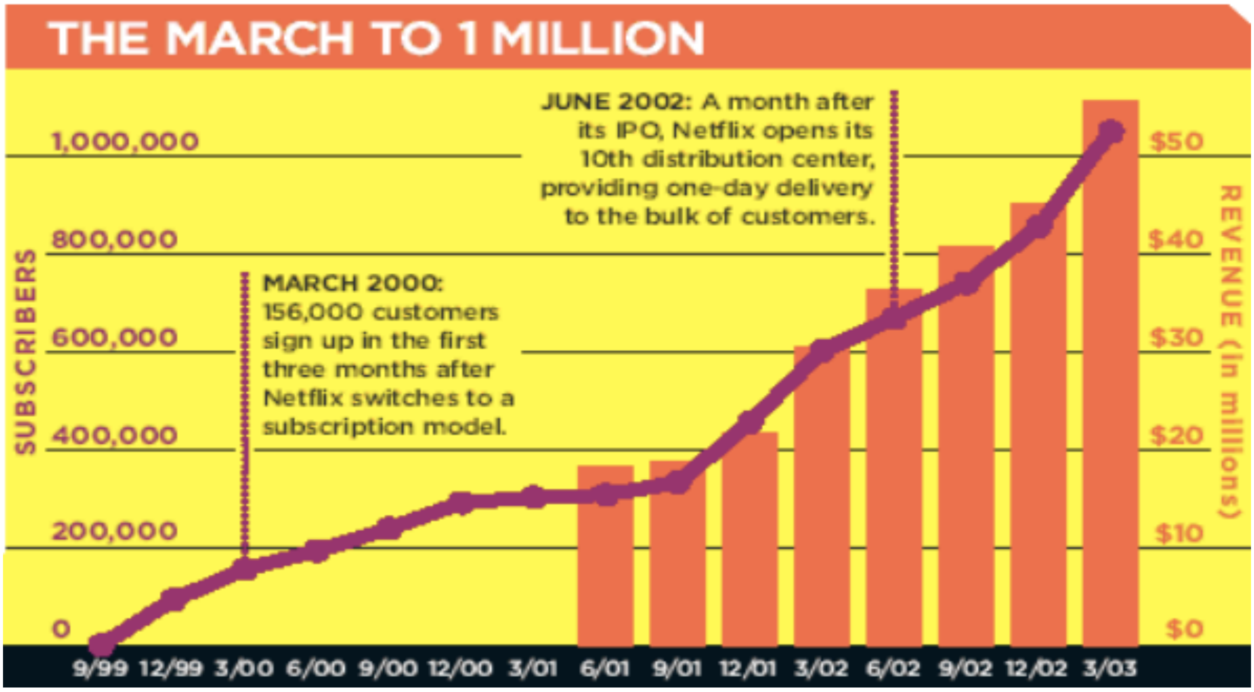

Figure1: Netflix subscriptions growth. Source: Business 2.0 “How Netflix is Fixing Hollywood”

Netflix’s strategic turning point and main strength was that of having customer’s enjoying DVD’s in their homes at all times and most importantly without having to pay late fees. However, this didn’t imply that customers could keep the DVD’s; as a matter of fact Netflix’s strategy pushed them to return anyway the items used. This because the platform gave the users the possibility to access “renting slots” in their profile, based on the type of subscriptions they had. The more they paid for the subscriptions, the more available slots they had for renting DVDs. The slots in fact remained occupied until the client returned the DVD they had previously rented.

Netflix’s main competitor in the DVD rental market was Blockbuster. For several years, while Netflix acquired more and more subscribers, Blockbuster didn’t introduce any opposing strategy to contrast its main competitor. “*Netflix has transcended the traditional model’s rental time constraints, demonstrating a more complete understanding of customer use needs*”[4]. One of the most important dates in Netflix’s history was the day of the first initial public offer (IPO) on March 23, 2002. It was only then that Blockbuster started to act in opposition of its competitor. They first started in 2003 by introducing an in-store subscription pass with unlimited renting availability and without a late fee[5]. Later in 2004, the company announced its online subscription service (Blockbuster online), which

[4] Stefan Michel, Stephen W. Brown, Andrew S. Gallan, *Service-Logic innovations: How to Innovate Customers, Not Products*, in California Management Review», L, 2008, 3, p.55.

[5] http://www.referenceforbusiness.com/history2/93/Blockbuster-Inc.html

delivered DVD's to the customer's home without shipping charges[6]. The newborn service at first helped blockbuster to obtain a reasonable amount of clients, but maintenance and transaction costs for the service were considered too massif to maintain. In fact in little time they saw themselves forced to abolish the "no late fee" policy that had previously attracted more subscribers. It was estimated that the costs for the service were of about 400 million dollars[7]. Apart from Netflix and Blockbuster, the market for DVDs in the US was also dominated by a third firm: Wal-Mart. Wal-Mart was specialized in the retailing from the big chain of stores from which was in possession. It was the first company to acknowledge that the market for DVDs had potential; in fact they offered a similar service as Netflix (with DVDs sent by mail and no late fees) but with lower costs. However Wal-Mart didn't present a big threat for Netflix, since Hasting's company could benefit from a much larger variety of DVDs and of bigger storages. An important turning point, which additionally fostered Netflix's position in the DVD renting market, was when they entered an agreement with Wal-Mart in 2005, which consisted in joint promotional activities for movie sales and rentals, which proposed to its own customers and subscribers to join the Netflix service.[8] Following this agreement, the only true competitor remained in the market was Blockbuster.

One of Netflix's key aspects for its success in the online-DVD-renting sector was the centralization of costumers needs as the core of its business model. To get in acquaintance with what subscribers had to suggest to improve the companies key features, Netflix created the so-called *Netflix Prize*. The *Netflix Prize* was a million dollar award granted by the company to anyone who sought to improve the accuracy of predictions about how much someone is going to enjoy a movie based on their movie preferences[9]. To this end, Netflix conceded almost one hundred million valuations of 18,000 securities for 480,000 clients. The Netflix Prize attracted almost 18,000 subscribers from 150 different companies and was won in 2009 by the team *Belkor's Pragmatic Caos*[10]. The team composed by AT&T research engineers won the price by formulating the best way to improve the company's movie recommendation algorithm, which generates an average of 30 billion predictions per day, by 10 percent or more[11]. Thanks to improvement provided for the service, Netflix finally sought the chance to outweigh Blockbuster as primary competitor for the market. The rivalry with Blockbuster ended with the bankruptcy of the firm in 2013.

[6] *Ibidem*
[7] Cfr. Jeanine Poggi, "Blockbuster's Rise and Fall: The Long, Rewinding Road", 23/09/2010, http://www.thestreet.com/story/10867574/1/the-rise-and-fall-of-blockbuster-the-long-rewinding-road.html
[8] http://www.marketline.com, reference code: 0F65E223-CCF4-4CBF-A37F-BA7C747C2040, 9/10/2015
[9] http://www.netflixprize.com
[10] http://techblog.netflix.com/2012/04/netflix-recommendations-beyond-5-stars.html
[11] http://www.wired.com/2009/09/bellkors-pragmatic-chaos-wins-1-million-netflix-prize/

1.2: A look into a new market: Over-the-top services

Netflix's objective was always the one of exploiting the Internet in order to rend the company as competitive as possible. With the periodic increase in the number of subscribers and with the defeat of the rival Blockbuster, a modification of the system seemed to be the best way to keep the company up to date with the continuous advances in technology. In those years there was a new market, which was attracting the attention of big companies such as Netflix. This new market was based on a new online-television content distribution system, the *Over-the-top service (OTT).* The term *Overt-the-top* refers to services, which are available over a network, but are separate from those of what your network providers offers. It's referred to as "over-the top" because these services ride on top of the service you already get and don't require any business or technology affiliations with your network operator[12]. Thanks to the transmission agreements, the OTT services can offer their clients a wide range of programs, which are already transmitted from traditional networks. Over the years several companies have established themselves in this new market, creating fierce threat to Netflix's position. Between these associations, the most recognized ones are *Hulu and Amazon Prime Instant Video*.

Hulu is a joint venture of television network created in 2008 by NBC Universal, Fox Entertainment, Disney-ABC Television and Providence Equity Partners[13]. It was developed as an *ad-supported streaming site* of contents already streamed in the web for which the company had already stipulated agreements. Hulu's main features, which have delineated its success, are easy intuitive users interface that streams video in a browser without separate application, a catalog of free content both deep and broad, and a good search capability to find the content[14]. While Hulu augmented its popularity in the OTT market, also Netflix gather a quite remarkable amount of success. Furthermore, although Hulu had an impressive increase in the amount of subscriptions and visualizations (from to 2008-2009 visualizations increased by 490%), Netflix had found a strategic advance for which they could rely on. They had decided to adapt the platform to a more specific range of viewers, creating the so-called *Netflix for Kids*, a system that managed information in order to provide content more suitable for minors[15]. This approach didn't only drastically increase Netflix's number of subscriptions and

[12] http://www.itvdictionary.com/definitions/over-the-top_definition.html
[13] http://www.g2mi.com/company_description.php?id=2839
[14] http://www.forbes.com/2009/01/22/hulu-amazon-newscorp_leadership_clayton_in_rc_0121claytonchristensen_inl.html
[15] Paul Stevens, How to Watch Netflix & Hulu Outside the US with Apple TV, p. 55
https://www.scribd.com/read/257340154/How-to-Watch-Netflix-Hulu-Outside-the-US-with-Apple-TV

views, but it also legitimized Netflix to be the only company to exploit this minor portion of the market.

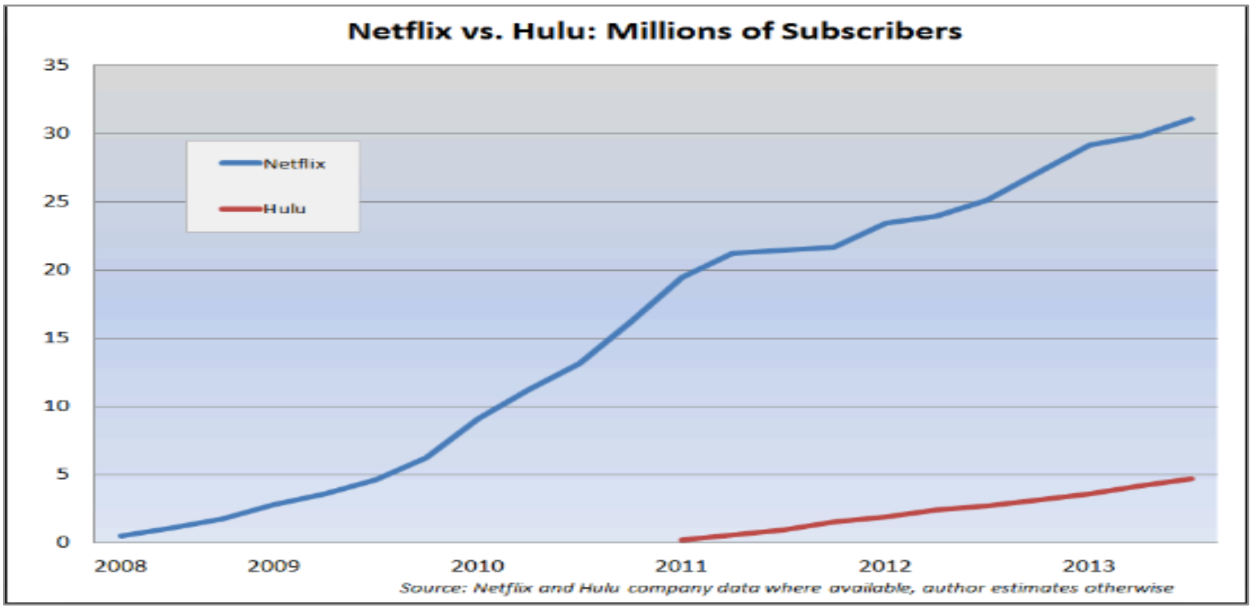

Figure 2: Netflix vs Hulu; Source: http://www.forbes.com/sites/markrogowsky/2013/12/19/hulus-billion-dollar-milestone-a-sign-of-just-how-far-behind-netflix-it-has-fallen/#20248cde559f

This figure (Fig.2) illustrates a comparison of the growth in the number of subscribers between two competitors for the market of online streaming services, Netflix & Hulu. As it can be clearly depicted from the graph, Netflix performed a more proficient exponential growth compared to its rival. This progress came as a consequence of the new strategies implemented by the company to modify its business plan. In fact targeting a new segment of customers resulted as a major step for the consecration of the company as head of the market for which it competed. The main difference between the two rivals in terms of strategic activity is that Netflix bases its fortunes on subscribers, being able to act almost exclusively on this element to obtain its profits, while Hulu centers its profits on the revenues derived from ads.

Over the last years Netflix found a new competitor in the market for OTT services, *Amazon Prime Instant Video*. Amazon has founded this platform in 2011 as a service, which offers customers the possibility to access a library with numerous TV-shows, movies, and e-books for a monthly subscription of $10.99[16]. *Amazon Prime Instant Video* is considered currently as Netflix's main competitor in the market. This consideration is driven by the fact that Amazon has made substantial

16 http://www.independent.co.uk/life-style/gadgets-and-tech/news/amazon-prime-video-company-launches-monthly-subscriptions-and-splits-off-streaming-film-and-tv-a6989306.html

investments to make its library competitive enough for the market. Specifically the most significant investments were made through the acquisition of transmission copyrights and permits with HBO[17]. However, thanks to the stability and to the solid base of subscribers acquired by Netflix over the years, the company has been able to gain a different reputation compared to its competitors Hulu and Amazon. Thanks to the financial solidity and to its prestigious reputation, the company took a major direction to establish itself as the main online streaming television establishment in the market achieving this through the creation of original content.

1.3 Biggest step into success: The passage to original content

Netflix is one of the most (if not the most) successful companies in the business mainly due to its strong background and its efficient strategies, which have allowed the company to always aim at the right target to boost growth. The main element of Netflix's profitability has been its continuous search for new consumer trends and demands. The company has perfectly embraced how costumers would ideally watch TV shows and movies, providing them an extensive library full of content at a relatively low price. The investment and realization of original content has also played an important part in the success of the company with Netflix identifying new streams of revenue from it, in addition to higher subscriptions. The variety of new original content is of vital importance for Netflix's attempt to a larger demographic audience. In fact since January 6th 2016, Netflix has significantly augmented its popularity offering its content platform in almost every country in the world, except the likes of China, Syria, North Korea, and Crimea[18]. Hastings stated in a keynote speech at the Consumer Electronics Show "*We are just beginning to break down the barriers so the world's best storytellers can reach audiences all over the world. The possibilities for building connections between cultures and people are endless and important.*"[19]

[17] http://www.huffingtonpost.com/2014/04/23/netflix-amazon-prime_n_5197950.html
[18] http://www.bbc.com/news/technology-35247309
[19] http://www.fool.com/investing/general/2016/01/09/ces-2016-reed-hastings-on-the-future-of-netflix.aspx

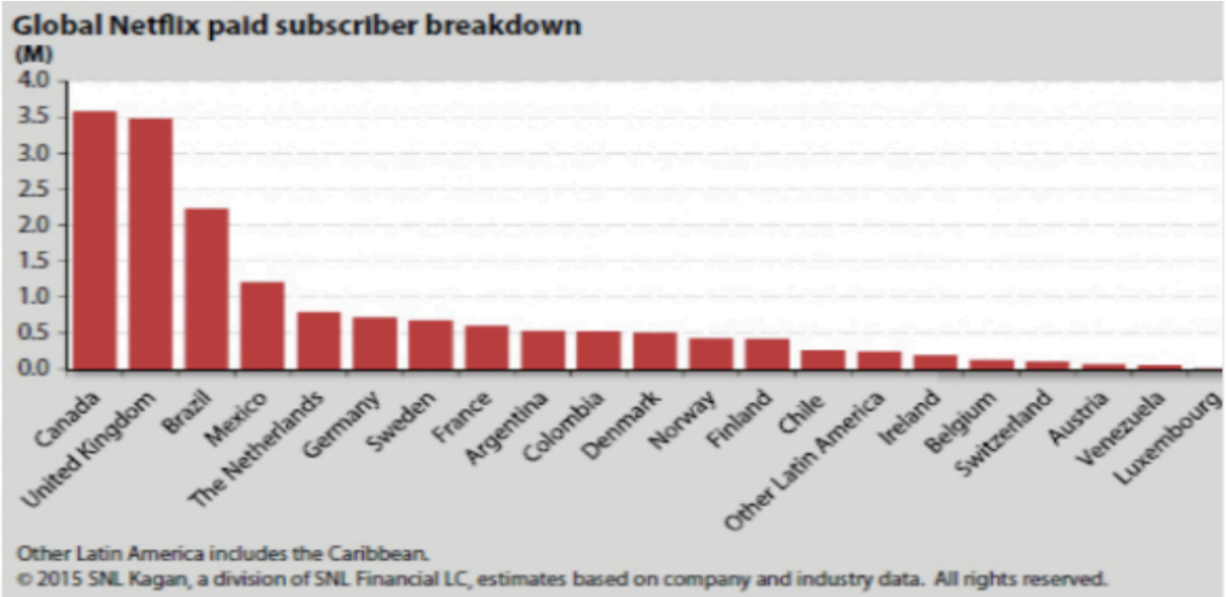

Figure 4: Global paid Netflix Subscribers, source: http://www.thewrap.com/netflix-global-paid-subscribers-by-country-canada-wins-photo/

Figure 4, shows the countries with the most Netflix subscriptions. The first country to adopt the arrival of Netflix was Canada, followed by the UK, Brazil, Mexico, and the Netherlands. Netflix's success in the market for *Over-the-top* services has attracted the attention of many giants of the television sector wanting to enter in the market. Examples of these new potential competitors are *Starz* and *CBS*, who were keen to create a new streaming platform.

An important date to keep in mind for Netflix's production of original content was February 1st 2013. This date remarks the uploading of the first season of Netflix's most successful original series *House of Cards.* The series has since attracted the attention of the public, having the company paying 100 million dollars per season. This however was considered to be a successful investment since the TV-Show was awarded with fourteen *Emmy* nominations. Apart from House of Cards, other important original TV-shows, which have had significant success, are: *Orange is The New Black (2013), Lilyhammer (2012), Narcos (2015), Hemlock Grove (2013),* and the fourth season of *Arrested Development (2013).*

1.4 The Future of Netflix

After having analyzed the company's history and main features, we will now move our attention on what Netflix's future could look like. How it could've been perceived from Netflix's history, the company's key points of success were its progressive innovation and its efficiency to center customers and their subscriptions as the core of their business idea. In little less than twenty-years the company has changed the way we relate to the internet and has made people recognize how much potential the web stores to develop ideas and cultivate new concepts. Netflix's acquired stability in the past makes the company have a solid background to work with in the future. Among the new projects that the company is trying to advance, there are two, which seem to be the most appealing: *Netflix Television,* and the *High Dynamic Range (HDR).*

The idea behind *Netflix Television* was born from an agreement between Netflix and three cable TV companies, RCN, Atlantic Broadband and Grand Communication, for the creation of a television platform[20]. The pros that could be raised from this agreement are: the entrance of Netflix in a new market (cable-TV), which attracts that portion of the population who is not "internet friendly" and it could solve one of Netflix's main issues i.e. the absence of publicity revenues for ads. On the other hand however, one of the main problems for which Netflix always had to face in order to ensure an efficient development of its project, was the presence of contracts which needed to be stipulated with the studios who were in possession of licenses and permits for Pay-Tv services. In fact Netflix had previously agreed for this licenses only for the use of online streaming shows, and not for the classic cable TV. Furthermore, to allow *Netflix Television* to be a concrete possibility, the company agreed to acquire some of these rights with important cable TV studios.[21]

The second main innovation for which Netflix wants to focus in the next years is definitely the *High Dynamic Range*, which is a new standard set for the quality of the image. The company has invested a considerable amount of capital in the development of this new feature, and it has since been between the first companies to display content in 4k, a new updated version of the HD. In addition this new characteristics, offers a perfect contrast between the lightest and the darkest sorts of the image. Investing on this new technology, Netflix aims at realizing and redefining new objectives. Above all, if the HDR reveals to be a success, the company would enjoy from all the benefits that come with first mover advantage, leaving competitors with empty hands. According to the website digital trends, the company plans to provide 600 hours of HDR content by the end of 2016.

[20] http://www.huffingtonpost.com/2014/04/24/netflix-cable_n_5209610.html
[21] http://variety.com/2014/digital/news/netflix-to-launch-on-three-u-s-cable-operators-via-tivo-1201163379/

1.5 Netflix in Italy

Netflix's constant growth over the years has permitted the company to initiate a process of expansion in other continents. The first step into the European market came in 2014 with the opening of the service in England and the Netherlands. The main target for the company in this process of expansion is to reach approximately 40 million potential users (about half of the users currently in the US) by 2020. The official proclamation of the opening of Netflix in Italy came on June 5th 2015 through an announcement in the companies twitter account. The arrival of Netflix in the Italian market immediately created stir between the main players in the market for national cable TV services (Mediaset, Sky, Rai). All these companies targeted Netflix as a main threat, in fact in the months prior to the opening in the domestic market they started forming internal agreements and alliances between them to contrast the American colossal. The first project that was born from these alliances was the so-called *TivúOn,* an on-demand service developed by Rai, Mediaset and La7, which purpose is to favor the diffusion of national cable TV through a digital satellite platform[22]. Another example of digital platforms which created competition to Netflix are Sky's premium content *Sky Go*, which has 4.75 million subscribers, Mediaset Premium's *Premium Play*, which has 1.77 million subscriptions, and Telecom's *Tim Vision*, which offers its 240,000 clients a library furnished with approximately six thousand titles between films and TV shows.[23]

Netflix took a courageous step by providing its service in a country like Italy, where it is well known that people love to stick to their traditions and don't always favor changes in their habits. Italy is also a country with a more than discrete history for the production of famous TV shows and movies. In fact, in a more recent context, the crime drama series *Gomorra,* produced by Roberto Saviano, drew more than 1.2 million views per episode, outnumbering the audience size of international series provided by Netflix such as *House of Cards* and *Daredevil*. However, the factors that might change the audience's reactions after the landing of Netflix on the Italian market are directly correlated to the offer that the company will propose. First of all, the price of the service should equal the price offered in the rest of Europe and in the US, i.e. around 7.99 euros/month, which is a more than affordable price considering the wide range of services offered[24]. By endorsing this subscription, the users will have access to a very vast catalogue of movies and shows compared to the Italian standards. Another aspect, for which Netflix has decided to rely on in order to attract more

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[22] http://www.iltempo.it/cultura-spettacoli/2015/06/05/rai-mediaset-e-la7-la-triplice-alleanza-per-fermare-netflix-1.1422726

[23] http://www.lexisnexis.com/hottopics/lnacademic/? "The challenges Netflix Faces During Southern Europe Expansion"

[24] http://www.wired.it/play/televisione/2015/06/29/intervista-reed-hastings-netflix/

subscriptions from the Italian audience, is the availability of a free month trial to test the efficiency of the digital platform.

It is well known that great success comes by taking many risks. Netflix's process of expansion in the rest of the world has required a significant investment from the company, with payments totaling billions of dollars for licensing streaming content both in the domestic market and in the international one. However the firm's success over the years has not only been characterized by the massive economical investments, but also and most importantly by their desire to create a relationship of trust and loyalty with their own subscribers.

Chapter 2: Netflix, Financial Position analysis

In the Last chapter I gave a general explanation of what has been Netflix's history, and on the achievements that the company has accomplished over the years. The company first started as a provider for online movie rentals reaching from 1997 (when it first launched) to 2008 approximately twelve million subscriptions. In 2008 the company then moved to the market for over the top services, or the market for online streaming content where it is still currently operating, rendering its services to approximately 70 million subscribers all around the globe. The following chapter is going to cover a financial statement analysis of Netflix Inc. specifically encompassing the years 2013, 2014, and 2015. I decided not to include the current year in motion (2016) mainly because the analysis is based on year-end results and not on quarterly results, and presently for obvious reasons records for 2016 are still not available. Financial data for this analysis was taken essentially from the companies website http://www.netflix.com and from other financial data banks such as Osiris and stock-analysis-on.net.

2.1 Liquidity

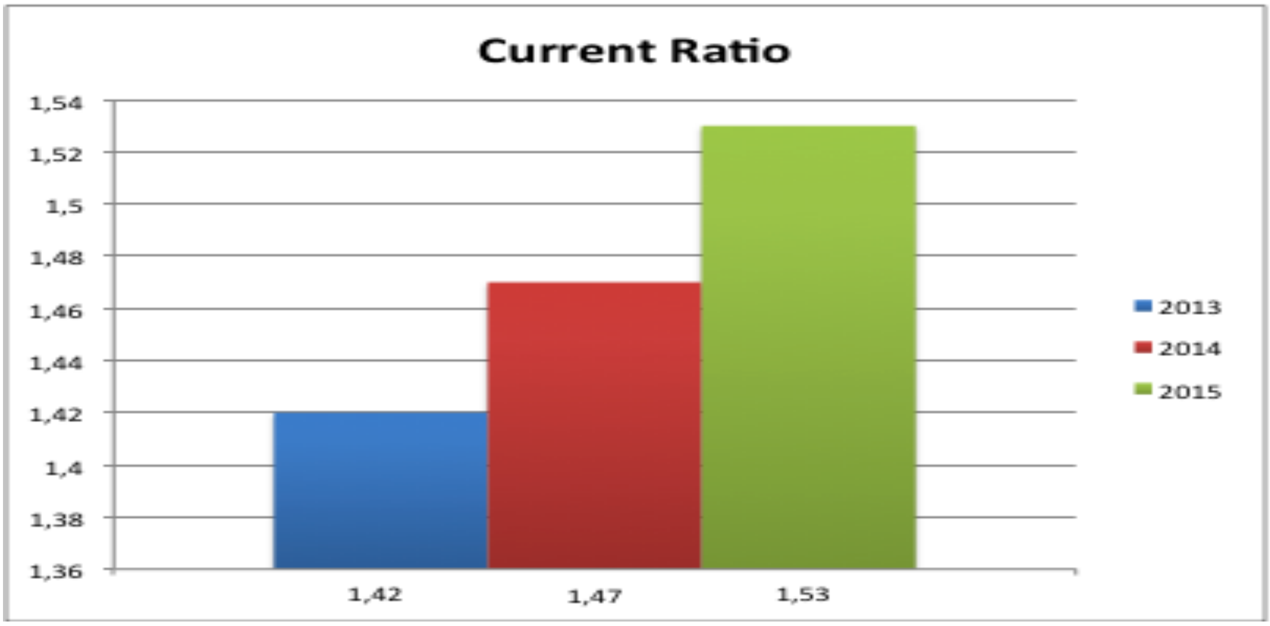

Figure 1: Current Ratio. Source: Based on data from Netflix Inc. Annual Reports

Liquidity is how easily can a company pay from existing assets for its ongoing expenses, including payroll, inventory, and capital equipment. The current ratio is a measure of a firm's liquidity in the short term and is obtained by dividing all current assets with current liabilities. This ratio shows whether a company is capable to meet its short-term financial obligations in an event of a disruption of its operations. Current assets are the asset of a company that are either cash or assets that can be converted into cash within the fiscal year. They include inventory, accounts receivable, and prepaid expenses. Current liabilities are expenses that a company will have to pay within the fiscal year. They include short-term and long-term debt as well as account payables[25]. Current assets at the end of the term for the year 2013 equals $3,058,763, while current liabilities amount to $2,154,203, therefore the current ratio equals $3,058,763 / $2,154,203 = 1,42. Current assets for 2014 equal $3,927,053 while current liabilities sum up to $2,663,154, resulting in a current ratio of 1,47. Ultimately current assets in 2015 amount to $5,431,840 and current liabilities equal $3,529,624, resulting in a 1,53 current ratio. In general a current ratio above 1.0 is an indicator of sufficient liquidity and a healthy balance between assets (what is owned) and liabilities (what is due). Netflix's current ratios for the years in account are all above 1.0 exhibiting a solid stability of the company along this three-year period.

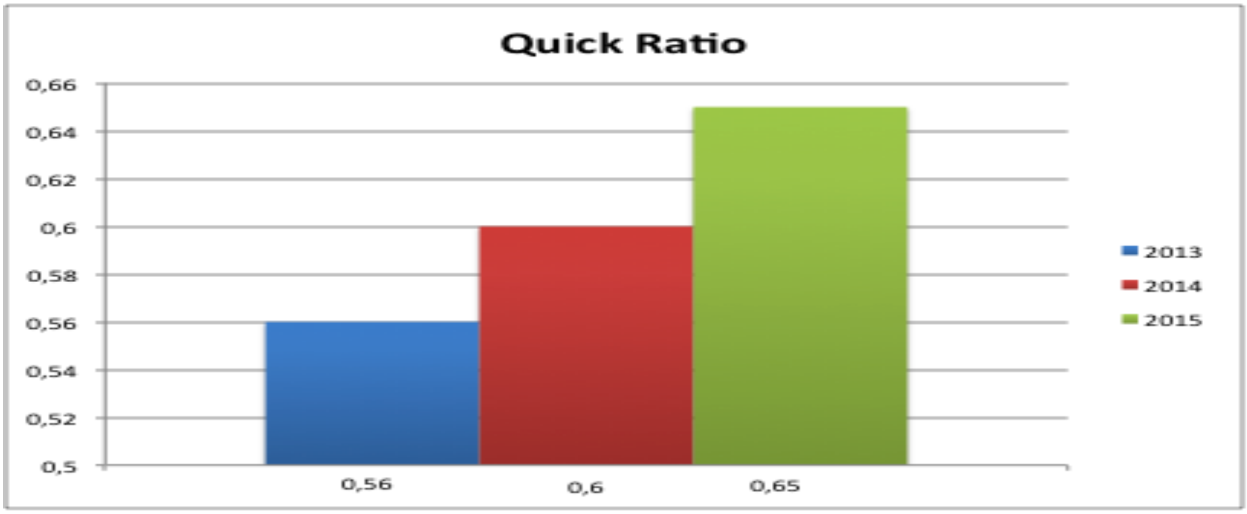

Figure 2: Quick Ratio. Source: Based on data from Netflix Inc. Annual Reports

The quick ratio or also recognized as the acid-test ratio measures a company's ability to cover their current liabilities with assets that can quickly be turned into cash. It excludes some of the current assets, which cannot be turned into cash, such as inventory. The formula to get this ratio is calculated by dividing cash plus accounts receivable plus short-term investments with current liabilities. A quick ratio of 1.0 or higher shows adequate liquidity. Netflix's acid test ratios for this three-year period are all quantities lower than 1.0, with amounts that sum up to 0.56 in 2013, 0.60 in 2014 and 0.65 in 2015. This means that current assets for Netflix are highly dependent on inventory, which is

[25] http://seekingalpha.com/article/1854501-how-healthy-is-the-balance-sheet-at-netflix

not necessarily a negative indicator, however it means that the company does not have enough liquid assets to contrast their current liabilities.

2.2 Financial Strength

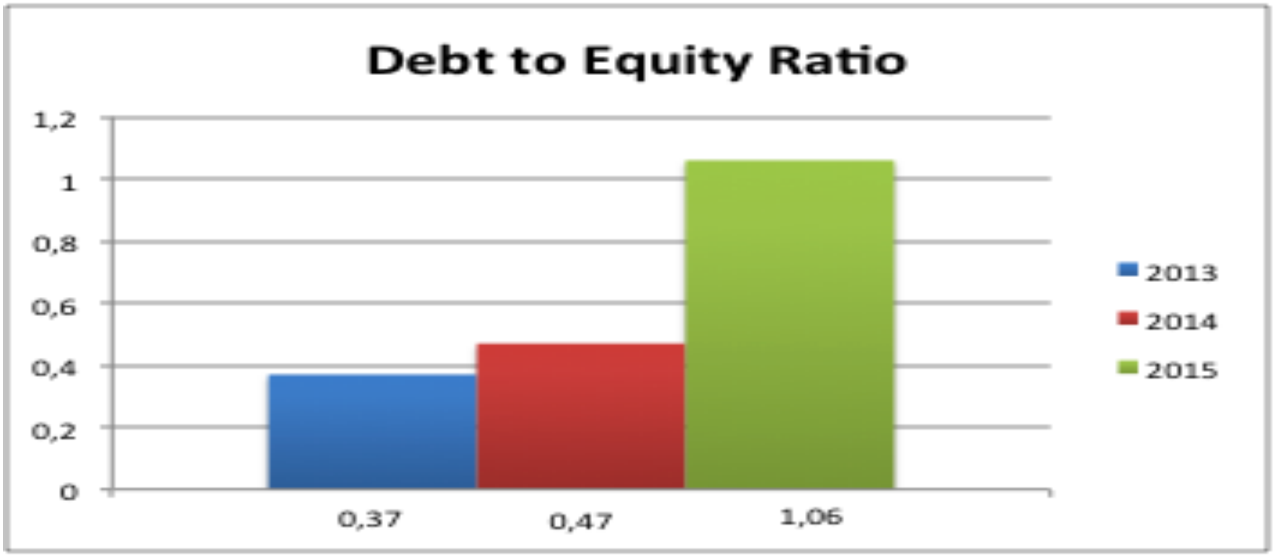

Figure 3: Debt to Equity Ratio.   Source: Based on data from Netflix Inc. Annual Reports

The Debt to Equity ratio is a form of debt ratio used as a measure to comprehend the financial strength and leverage of a company. It essentially indicates how much debt a company is using to finance its assets relative to the amount of value represented in shareholders' equity[26]. The formula of the debt/equity ratio is obtained by dividing total liabilities by stockholder's equity. When evaluating this ratio, the smaller is the ratio (should always be less than 1.0) the better as the company is financially stronger the less debt it has compared to equity. Equity is the amount of money shareholders have invested in the company, plus the net income that has been earned and retained. In 2013 total liabilities equaled $500,000 and equity equaled $1,333,561, resulting in a debt/equity ratio of 0.37; in 2014 total liabilities summed up to $885,849, while equity equaled $1,857,708 resulting in a ratio of 0,47. From these results it could be depicted how Netflix in 2013 and 2014 maintained a debt/equity ratio substantially lower than 1.0, indicating a strong financial position with earnings outnumbering debts. This also means that most of the funds used for the development of various projects and payments for content licenses came mostly from the company's equity. However in 2015 Netflix's debts suffered a significant increase, this mainly due to the company's expansion in the international market, specifically in Italy, Spain, Portugal, Japan, Australia, and New Zealand. Another factor, which explains Netflix's increasing debts in 2015, was the partnership agreement

[26] http://www.investopedia.com/terms/d/debtequityratio.asp

with SoftBank, one of the leading mobile providers in Japan. According to the partnership, SoftBank was of fundamental importance for the launch of Netflix in Japan and initially financed some of the company's expenses[27]. Liabilities in 2015 totaled $2,371,362 while equity amounted to $2,223,426 resulting in a debt/equity ratio of 1.06.

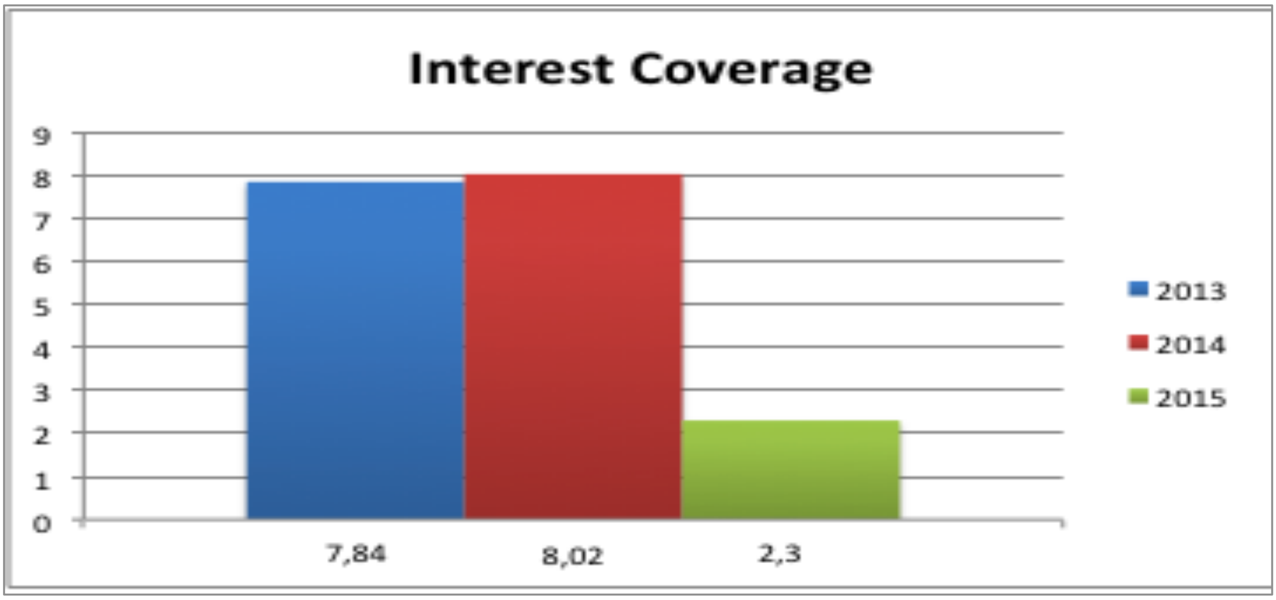

Figure 4: Interest Coverage. Source: Based on data from Netflix Inc. Annual Reports

Interest Coverage is an analytic proportion used to measure financial strength of a company. This solvency ratio is important for evaluating financial health looking at the company's current operating profit versus the amount of interest it has to pay to debt holders. In fact the formula for this ratio is obtained by dividing operating profit/income by interest expenses. An alternative way to obtain this amount is by dividing EBIT (earning before interest taxes) by interest payments. Interest coverage should be above 2.5, to indicate that operating profit is more than interest expense. In 2013 operating profits equaled $228,347 and interest expenses equaled $29,142, resulting in an interest coverage ratio of 7.84; in 2014 operating profits equaled $402,648 and interest expenses equaled $50,219, resulting in an interest coverage ratio of 8.02; in 2015 operating profits summed up to $305,826 while interest expenses equaled $132,716, resulting in an interest coverage ratio of 2.3. From these results it could be seen how Netflix's interest coverage improved from 2013 to 2014, but then significantly deteriorated from 2014 to 2015. In fact an interest coverage of less than 2.5 is a sign of warning, meaning that company should be careful not to dip further with its borrowings because it increases both debt and interest expenses. Since Netflix is a publicly listed company, it should be very careful at improving the numbers of the last fiscal year regarding interest coverage since this

[27] Market Line

ratio tells a lot about the company's financial health. Investors tend to rely a great deal on this ratio to have an idea on the ability of the company to pay back its interests and debts for future obligations.

2.3 Profitability

2.3.1 Return on investment

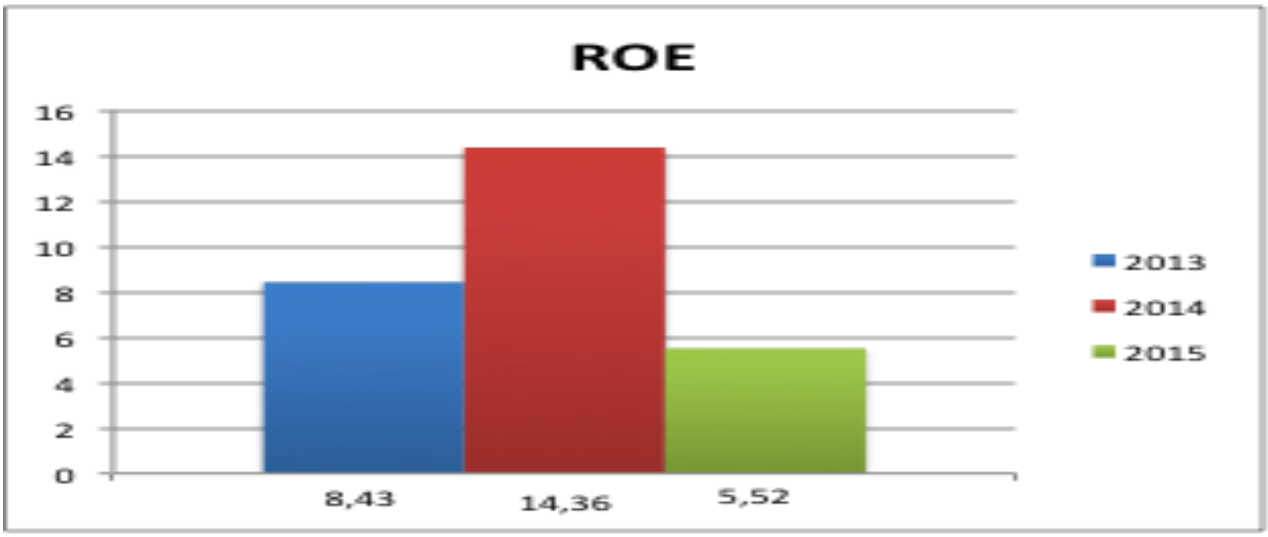

Figure 5: Return on Equity. Source: Based on data from Netflix Inc. Annual Reports

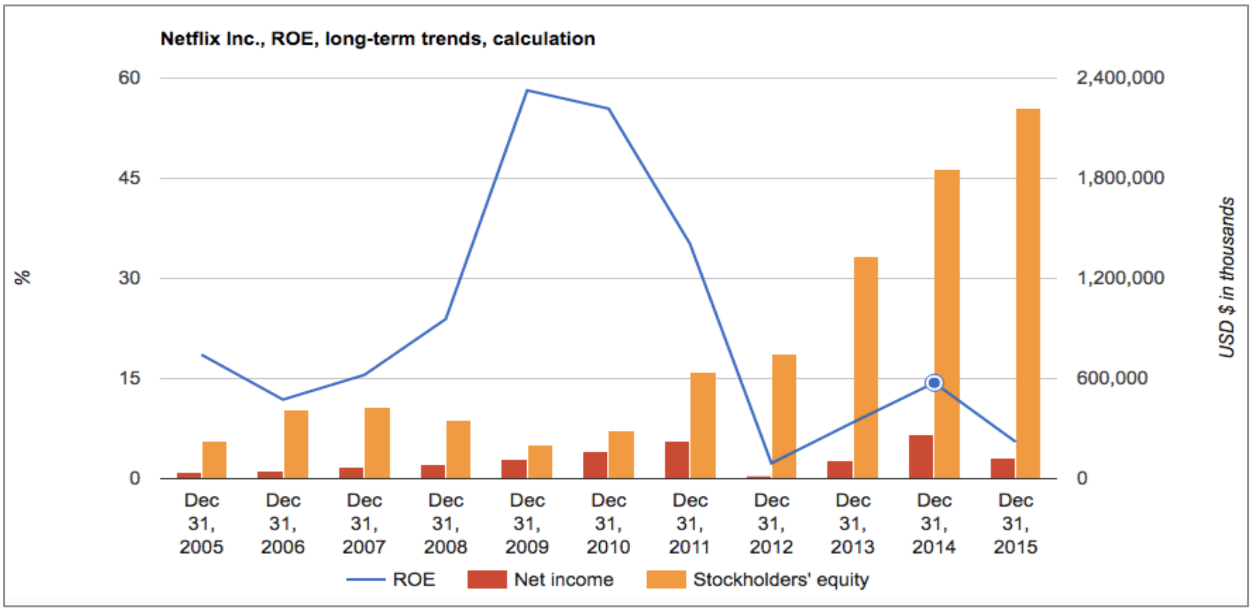

Figure 6: ROE long-term trends. Source: https://www.stock-analysis-on.net/NASDAQ/Company/Netflix-Inc/Long-Term-Trends/ROE

Profitability Ratios are used to assess a company's ability to generate earnings, based on revenues generated or resources used. ROE (Return on Equity) is an indicator of a company's earnings and profitability by revealing how much profit a firm generates due to stockholder's investments. ROE is expressed in percentage and is obtained by dividing net income with stockholder's equity. From Figure 7 it can be depicted how Netflix's stockholder equity has had a steady increase since 2009. On a historical note, from this chart it could be deduced the importance of Netflix's passage from the DVD rental industry to the market for digital streaming content in 2008. The occurrence of this event was in fact crucial for the stockholders who invested capital in this company, with equity increasing at impressive rates every year. However, going back to the ROE analysis, it could be seen how this factor has had a much more volatile trend compared to the steady increase of stockholder's equity. Thus it can be concluded that the main aspect in ROE's outgoing volatility are the unstable changes in net income. Net income in 2013 summed up to $112,403, while stockholder's equity summed up to $1,333,561, thus when dividing these two numbers up and multiplying them by 100 would result in a ROE of 8.43%. In 2014 net income was equal to $266,799, while stockholder's equity summed up to $1,857,708 resulting in an increased ROE of 14.36%. In 2015 the company suffered a significant deterioration in the ROE, mostly due to the fall in net income. Net income in 2015 amounted to $122,641, which is an important loss considering the $266,799 earned in the previous year. Stockholder's equity instead increased to $2,223,426, with the results ending up in a ROE of 5.52%.

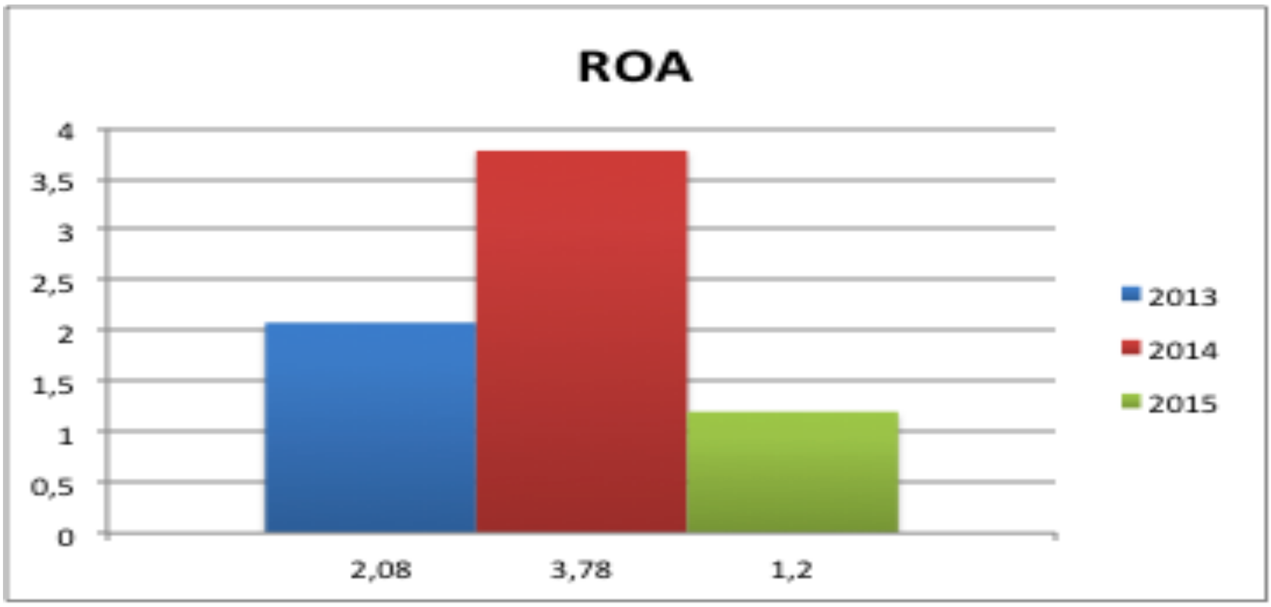

Figure 7: Return on Assets. Source: Based on data from Netflix Inc. Annual Reports

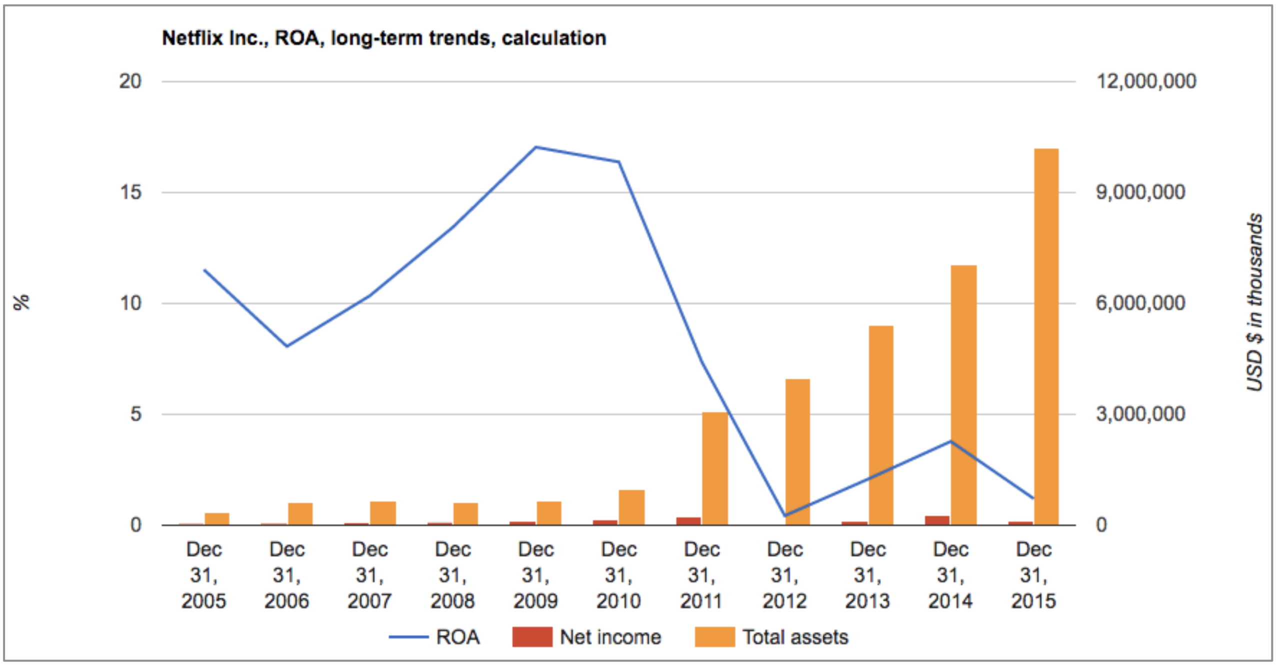

Figure 8: ROA long-term trends. Source: https://www.stock-analysis-on.net/NASDAQ/Company/Netflix-Inc/Long-Term-Trends/ROA

The ROA (Return on Assets) is a measure of profit on all capital invested in the business which is used to acquire assets. It tells you how much earnings management is generating for every dollar of assets at its disposal. The formula for ROE is net income divided by total assets. ROE is impacted by the Debt to Equity ratio of the specific company, while the ROA ratio eliminates the impact of the source of financing, regardless if it is debt or equity to measure management efficiency. That is why it is good to observe both ratios when comparing companies. In Netflix's business model assets primarily include subscriber's subscription fees and expenses include subscribers' acquisition costs such as marketing, and amortization of streaming content. By observing figure 9, it is evident how total assets for Netflix experienced a steady increase since 2005, while net income values where pretty unstable. Net income in 2013 summed up to $112,403, while total assets amounted to $5,412,563, thus when dividing these two numbers up and multiplying them by 100 would result in a ROA of 2.08%. In 2014 net income was equal to $266,799, while total assets summed up to $7,056,651 resulting in an increased ROA of 3.78%. In 2015 the company suffered a substantial depreciation in the ROA, mostly due to the fall in net income. Total Assets instead increased to $10,202,871, with the results ending up in a ROA of 1.20%, which is pretty low considering the reputation of the company.

2.3.2 Return on Sales

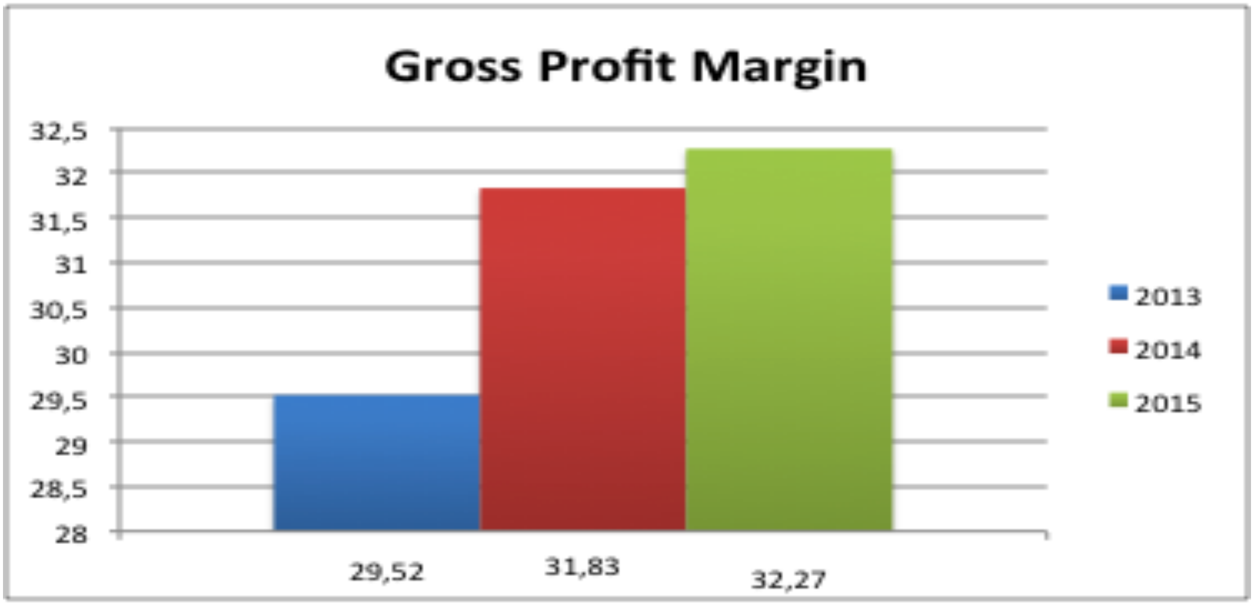

Figure 9: Gross Profit Margin. Source: Based on data from Netflix Inc. Annual Reports.

Gross Profit Margin, is the profit the company made on sales after costs of good sold, it is used to look at profitability as a percentage. Subtracting costs of goods sold from revenues (Revenues – Cost of good sold = Gross Profit) and then dividing the quantity by revenues generates the Gross Profit Margin. The higher the gross profit margin the more efficient is the company's ability to control its costs. Gross profit margin for Netflix maintained a steady increase over this three-year period, meaning that the company was able to successfully amortize its costs. Gross profits for 2013 were $1,291,306, while revenues equaled $4,374,562 resulting in a gross profit margin of 29.52%. The 31.83% profit margin in 2014 came from dividing $1,752,896 gross profits with $5,504,656 revenues. In 2015 this number additionally increased to 32.27%, which came from $2,188,035 in gross profit and $6,779,511 in revenues. The main indicators of the periodical increase in this ratio came thanks to Netflix's fulfillment of its expenses for what concerns geographical expansion, streaming rights, and developed customer services, and to its substantial increase in revenues. Since Netflix is predominantly a subscription-based company, the expansion in international territory and thus the attraction of additional subscribers, enhanced a more considerable growth in its revenues.

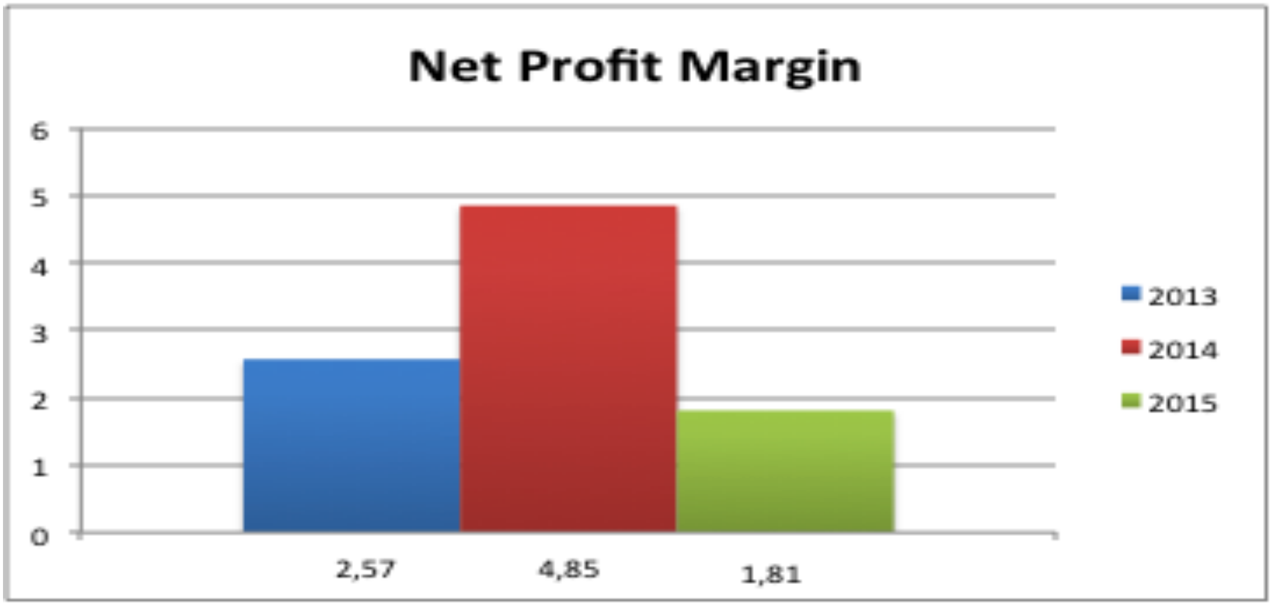

Figure 10: Net Profit Margin. Source: Based on data from Netflix Inc. Annual Reports.

Net Profit Margin is a ratio that shows how much of each cash collected as revenue transforms into profit. The equation is calculated as a percentage and is obtained by dividing net profits with revenues. Low profit margins don't necessarily mean that a company has low profits. In fact Netflix doesn't present very high numbers for this ratio, but on the other hand has delivered very high returns for its stockholders. Figure 10, evidences the volatile trends in net profit margin from 2013 to 2015. In 2013 net profit margin summed up to 2,57%, which came from the ratio between $112,403 in net income and $4,374,462 in revenues. In 2014 net profit margin almost doubled to 4.85%, as a result of the increase in both net income ($266,799) and revenues ($5,504,656). Unfortunately this important ratio suffered a considerable drop in 2015, with the percentage decreasing to 1.81%. This was due to decline in net income from $266,799 in the previous year, to $122,641.

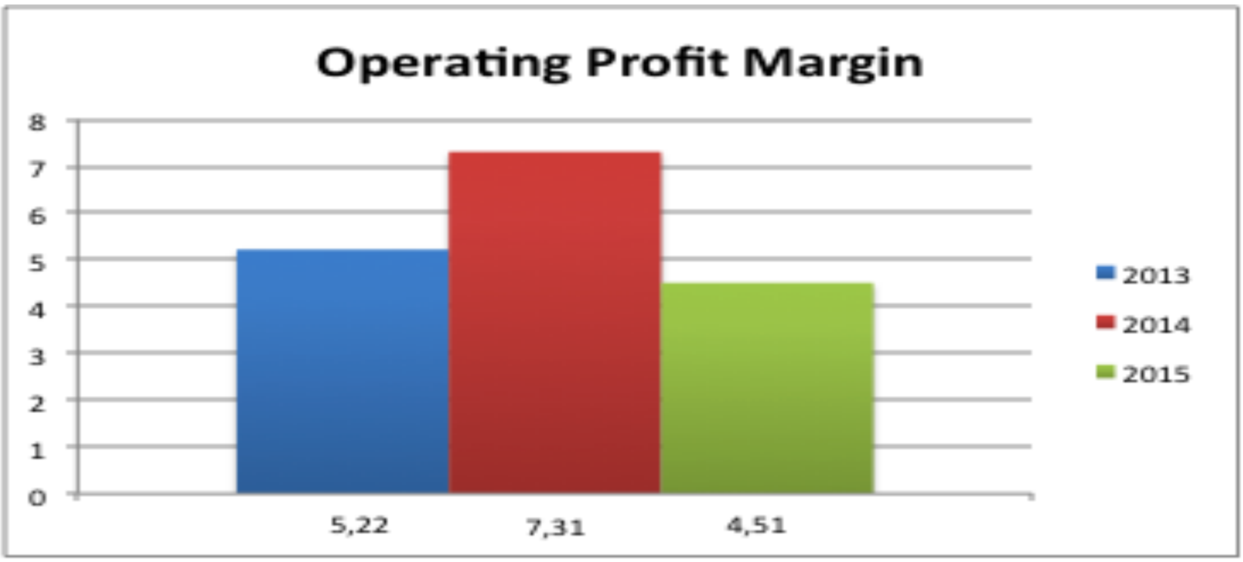

Figure 11: Operating Profit Margin. Source: Based on data from Netflix Inc. Annual Reports.

The operating profit margin measures the percentage of each sales remaining after all costs and expenses, other than interest, taxes, and preferred stock dividends are deducted. It represents the pure profits earned on each sales dollar. Operating profits are pure because they measure only the profits earned on operations and ignore interest, taxes, and stock dividends (Gitman, Principles of Managerial Finance). A high operating profit margin is preferred, and is calculated by dividing operating profits with net sales (revenues). Operating profits are obtained after removing operating expenses such as cost of goods sold, wages, and depreciation from the revenues. A company's operating margin also determines how well the company can satisfy creditors and create value for stockholders by generating operating cash flow. A healthy operating margin is also required for a company to be able to pay its fixed costs such as interest on debt, meaning that a company with high margin has less financial risk with respect to a company with a low margin[28]. For Netflix, it could be seen from the chart in figure 11 how operating profit margin increased from 2013 to 2014, and then depreciated from 2014 to 2015. In 2013 the margin was of 5.22%, with operating profits summing up to $228,347 and revenues to $4,374,562. This amount then notably increased as high as 7.31% in 2014, thanks to the increase in operating profits to $402,648 and in revenues to $5,504,656. The following year however the margin suffered an additional drop due to increased operating and fixed expenses such as interests, wages, and depreciation of its assets. The increases in expenses are mostly due to the constant expansion of the business in international territory and to the continuous partnerships with important corporations that partially finance the firm's innovations. Operating profit margin in 2015 amounted to 4.51%, with operating income sinking to $305,826.

[28] http://www.investopedia.com/terms/o/operatingmargin.asp?ad=dirN&qo=investopediaSiteSearch&qsrc=0&o=40186

2.4 Short-term Operating Activity

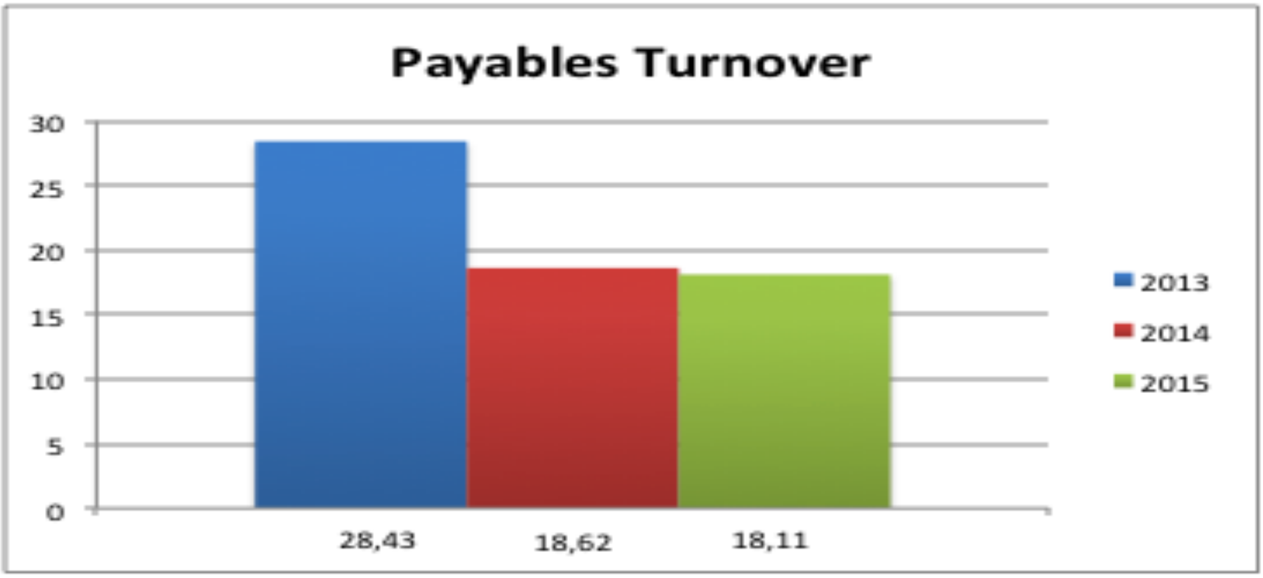

Figure 12: Payables Turnover. Source: Based on data from Netflix Inc. Annual Reports.

Payables turnover is an activity ratio used to quantify the rate at which a company pays off its suppliers. This ratio is measured by dividing cost of goods sold or cost of revenues with accounts payable. Activity ratios indicate the speed with which accounts are converted into sales or cash inflows/outflows. Payables turnover are very important when analyzing a publicly listed company's stock for an investment opportunity, as it evidences how fast the company pays back its short-term debt obligations. In the case of Netflix it could be seen from the chart in figure 12, that the turnover ratio is decreasing every year from 28.43 in 2013 to 18.62 in 2014 and finally dropping to 18.11 in 2015. The amounts aren't very low, however it means that Netflix every year is taking longer to pay off its debts and obligations. Another important financial measure to take into consideration for what concerns future debts is the average accounts payable payment period, or also known as the accounts payable days outstanding. It is calculated by dividing accounts payable with costs of good sold, and then multiplying the result by 365 days. This ratio is used by both companies and investors who are thinking about getting in business with other companies, as is an indicator of how fast a company pays its bills and future expenses. Netflix's average payables payment period, summed up to an average of 13 days in 2013, and 20 days in 2014 and 2015. As it could be depicted from this numbers, Netflix is a fast and efficient payer of its debts and short-term obligations.

2.5 Long-term Investments

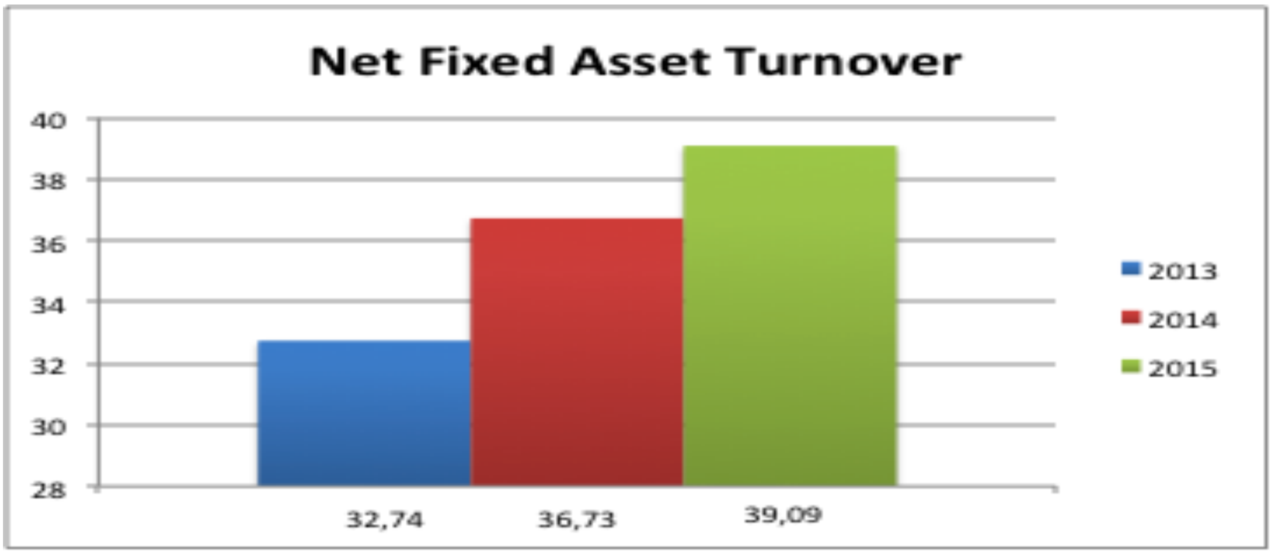

Figure 13: Net Fixed Asset Turnover. Source: Based on data from Netflix Inc. Annual Reports.

Net fixed asset turnover ratio measures the efficiency of a company's use of its fixed assets when creating sales revenues. A higher fixed asset turnover ratio indicates that a company has efficiently invested in its fixed assets to generate sales revenues. The formula for this ratio is obtained by dividing net sales (revenues) to fixed assets, namely property, plant and equipment. It is a very helpful ratio to use for investors who want to compare companies' performances, as it indicates how effectively these companies arrange their operating activities. Netflix's net fixed asset turnover ratio has periodically increased from 2013 to 2015, as a result of an improvement in both net sales and fixed assets. The ratio increased from 32.74 in 2013 to 36.73 in 2014, due to an increase in revenues from $4,374,562 to $5,504,656 and in property, plants, and equipment from $133,605 to $149,875. In 2015 net fixed asset turnover equaled 39.09 as a result of high revenues $6,779,511 and property, plants, and equipment $173,412.

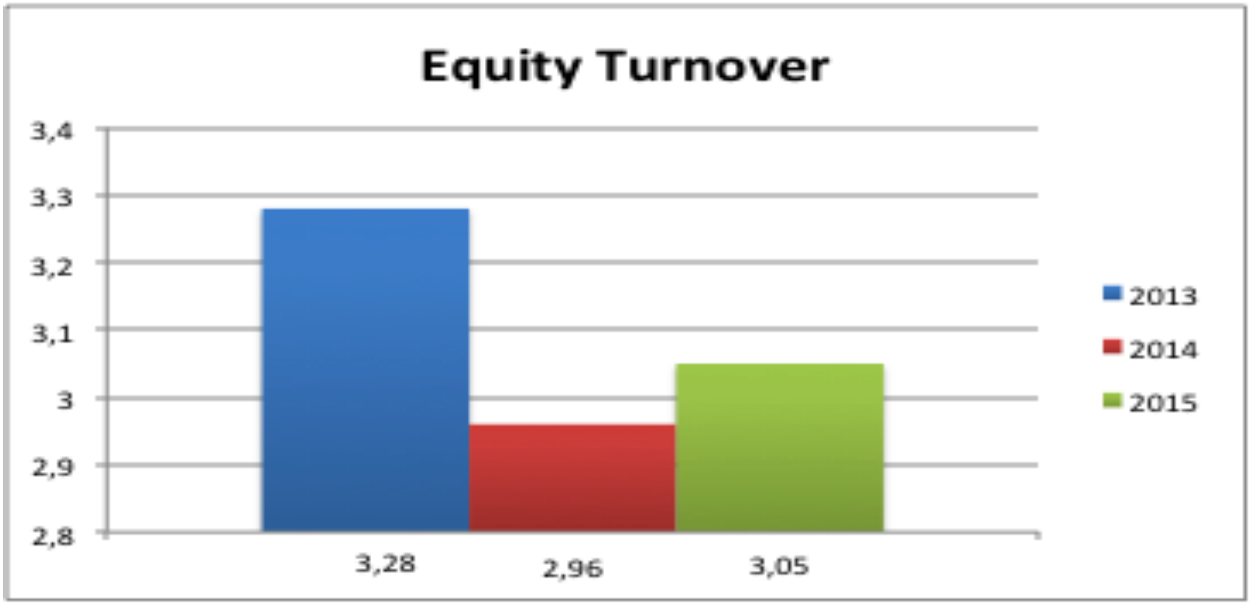

Figure 14: Equity Turnover. Source: Based on data from Netflix Inc. Annual Reports.

Equity turnover is an activity ratio used to measure a company's proficiency when targeting long-term investments. It measures the efficiency in which a company's management uses equity to generate revenue. The formula is determined by the ratio between net sales and stockholder's equity. The higher the ratio the better, as it means that the company is effectively using its capital. The chart in figure 14 illustrates the equity turnover ratios from 2013 to 2015. I can be seen how the numbers for this ratio where volatile along the three year period. In 2013 the company had a fairly high ratio of 3.28, which came as a result of the ratio between $4,374,562 in revenues and $1,333,561 in stockholder's equity. A ratio of 3.28 means that for every dollar invested in equity, the company will generate 3.28 dollars in revenue. The following year, this amount suffered a drop to 2.96 due to a considerable increase in investments in stockholder's equity (from $1,333,561 to $1,857,708). However equity turnover slightly improved again in 2015 summing up to 3.05 per dollar invested, thanks to higher returns on sales and to increased number of subscriptions in countries such as Australia and New Zealand. Revenues in fact increased from $5,504,656 to $6,779,511.

Chapter 3: Netflix vs. Competition

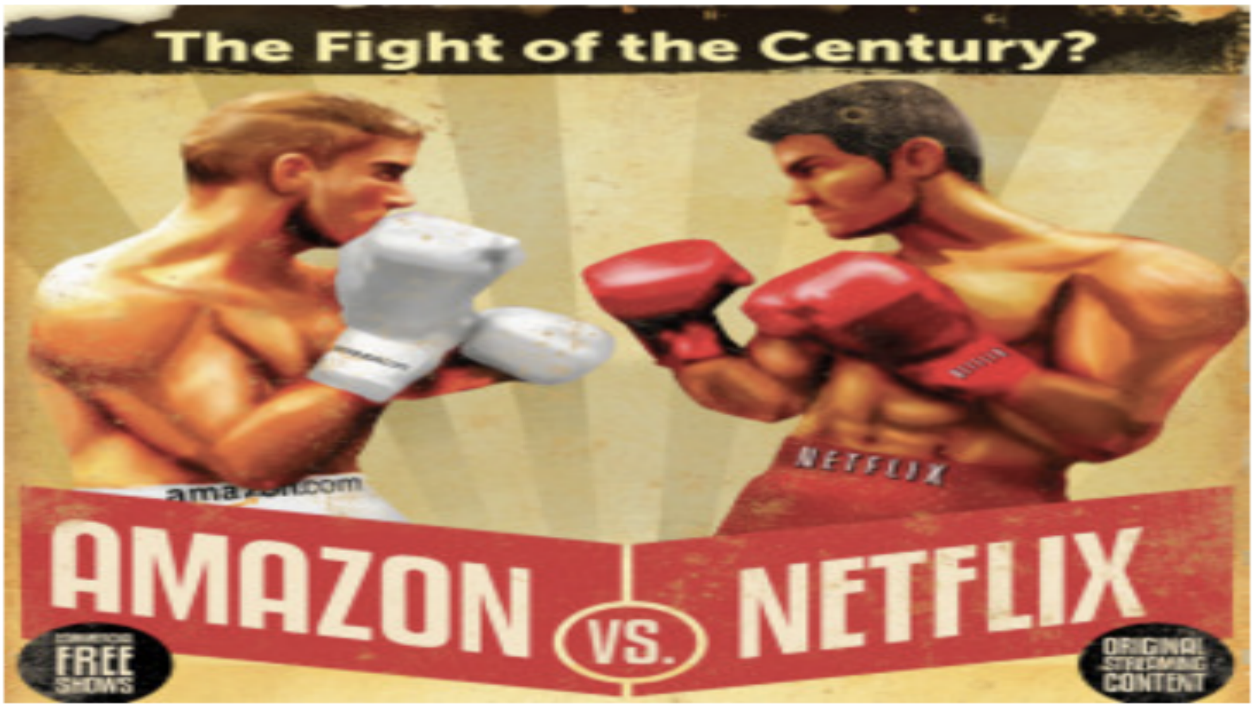

Figure 1: Source: http://www.business-management-degree.net/features/amazon-vs-netflix/

When wanting to investigate and evaluate the main features of a public listed company the size of Netflix, there are many variables to take into account. One of the most important is definitely analyzing a company's financial condition and thus the success that it can attain in the market for which it serves. The last chapter covered Netflix's financial position over a three-year period, from 2013 to 2015, analyzing the company's key ratios based on its balance sheet and income statement account. The company overall presented an important solidity in terms of liquidity, profitability, and disposition of its assets. It has over $1 billion in cash and cash equivalents, which can be used to make important investments and expand the company's horizons in the future. This chapter is going to encompass a more comparative approach compared to the last chapter by putting into comparison two colossal of the industry for online streaming services, Amazon and Netflix. It will evidence both companies' financial solidity as a result of their consolidated business plans. The parallelism will be made in accordance with the data gathered for each company's key financial performance indicators, which are divided by Liquidity, Profitability, Equity, Efficiency, Investments, and Operating Activities.

3.1 Brief Description of Amazon's Business Strategy

Amazon was founded in 1994 by the American technology entrepreneur Jeff Bezos. In a few years time the company became the most famous Internet retailer in the world[29]. The company who was first born as an online bookstore, an initiative which was highly criticized by many, today is a giant that operates in the B2C (Business to Consumer) e-commerce industry by selling directly to their customers not only books but also electronic accessories, computers, telephones, clothing, music, furniture, house products, garden equipment, between others[30]. Since its earliest years of foundation, Amazon has always found it difficult to generate substantial amounts of revenue. The company of Seattle spends tons of money into content development, upgrades, free shipping and above all sells articles at a price lower than the production costs. All this without forgetting expenses such as physical expansion of the company and payments for storage departments and warehouses. After opening the website in 1994, the company initially avoided paying local taxes for sales in countries where they did not have a physical presence, such as a warehouse. But now however, many of these countries are demanding the application of taxes for the sale or re-sale of its products, leaving Amazon with additional expenses to forgo. To finance some of their investments Amazon has suffered of almost three billion dollars of long-term debt, and its interest expenses almost doubled in the previous year[31]. In recent years (2011), Amazon has implemented a new upgraded service called *Amazon Prime*, which consists in offering clients free shipping and instant deliveries for an annual fee of $99. This service however, didn't have a positive impact on the company's net profit since the shipping costs that Amazon claims for its customers far exceed the annual subscription fee. In other words, the more products Amazon sells to its customers the more money it loses. In fact Amazon's ability to make profit largely depends on shipping costs, with a considerable part of its expenses related to transportation. The following figure illustrates a comparative chart evaluating Amazon's periodic trend for revenues and net profits for the years 2009 to 2015.

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29 http://darkwhite666.blogspot.it/2016/06/il-modello-di-business-di-amazon-conti.html

30 http://backtowork.ilsole24ore.com/newsletter/index.php/2013/07/il-modello-di-business-di-amazonuna-lezione-anche-per-le-piccole-imprese/

31 ibidem.

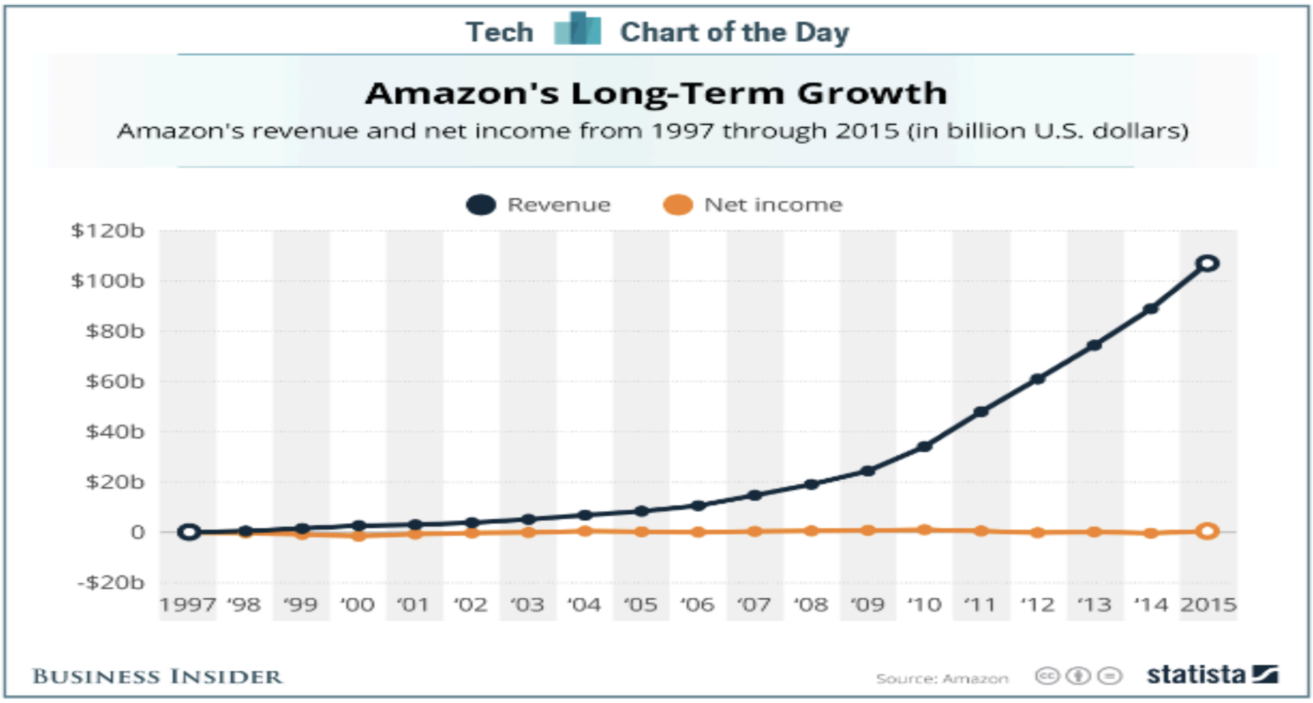

Figure 2: Amazon Revenues and Net Income; Source http://uk.businessinsider.com/amazon-revenue-vs-profit-2016-1?r=US&IR=T

As it can be depicted from the graph, revenues show a pretty steady increase from years to years, this mainly due to the effectiveness of the company in terms of selling and retailing a vast quantity of products of every type. On the other hand, fluctuations for net profits show an unstable tendency, this due to the many expenses, which the company has to encounter to maintain its position as leader in the e-commerce industry, and in order to sustain an efficient service of its products. Amazon's strategy has always been the same for 20 years: re-invest part of their profits in order to maintain the company innovative, competitive and efficient.

3.2 Amazon Prime Instant Video

Amazon Prime Instant Video is considered currently as Netflix's main competitor in the market for on demand streaming video content. This consideration is driven by the fact that Amazon has made substantial investments to make its library competitive enough for the industry. This complementary service was born in 2011, as a free addition to the already existing service Amazon Prime. The platform consists in a $10.99 monthly subscription and disposes of a catalogue of 41,000 items divided between movies and TV-shows[32]. Since Amazon Instant Video is an example of a complementary business model, i.e. a service, which is used as bundle feature to another main

[32] http://www.tomsguide.com/us/what-is-amazon-prime,news-18041.html

service, the implementation of it serves as a strategic opportunity for Amazon to attract customers. In fact, Amazon can count with more than 60 million subscribers from all around the globe, this as a result of the customer loyalty enhanced by the disposition of bundled goods and services at a very moderate price of $99 a year[33]. Amazon licenses content from broadcasting networks and cable providers, and it delivers quality HD videos, which are comparable to it competitors Netflix and Hulu. Revenues come exclusively from either Amazon Prime's $99 annual subscription, or by the $10.99 instant video subscription.

3.3 Financial Aspects:

In the next section, the main components, which embody the financial position of both companies, are going to be discussed. The following table illustrates the key financial parameters of Amazon and Netflix, in the period which concerns the years 2013 to 2015. Data for these performance ratios where obtained from: the stock analysis website financials.morningstar.com (for Amazon), and from Netflix's company website.

Key Ratios	**Netflix**			**Amazon**		
Liquidity Ratios	2013	2014	2015	2013	2014	2015
Current Ratio	1.42	1.48	1.54	1.07	1.12	1.08
Quick Ratio	0.56	0.60	0.65	0.74	0.82	0.77
Debt to Equity Ratio	0.37	0.48	1.07	3.12	4.07	3.89
Profitability Ratios						
ROE	8.4%	14.4%	5.5%	2.8%	-2.2%	4.4%
ROA	2.1%	3.8%	1.2%	0.7%	-0.5%	0.9%
Gross Profit Margin	29.5%	31.8%	32.3%	27.2%	29.5%	33.0%
Net Profit Margin	2.6%	4.9%	1.8%	0.4%	-0.3%	0.6%
Operating Profit Margin	5.2%	7.3%	4.5%	1.0%	0.2%	2.1%
Equity Ratios						
Earnings per Share	0.26	0.62	0.28	0.59	-0.52	1.25
Efficiency Ratios						
Assets Turnover	0.93	0.88	0.79	2.05	1.88	1.78
Short-Term Operating Activities						
Payables Turnover	28.43	18.62	18.11	2.48	2.39	2.33
Long-Term Investments						
Net Fixed Assets Turnover	32.74	36.73	39.09	6.79	5.24	4.89
Equity Turnover	3.28	2.96	3.05	7.64	8.28	7.99

Figure 3: Table of Financial Performance Ratios

33 http://fortune.com/2016/07/11/amazon-prime-customers/

3.3.1 Liquidity:

As explained in the previous chapter, Liquidity ratios are used to determine a company's ability to pay off its short terms obligations. Higher proportions imply that a company has a higher edge of wellbeing in covering transient obligations. An organization's capacity to transform short-term assets into cash to cover obligations is absolutely critical when creditors are seeking for installments. For this specific case, the liquidity analysis is going to compare data of both companies, covering current ratio, quick ratio, debt to equity ratio, and interest coverage.

From 2013 to 2015, both companies have maintained a current ratio (current assets / current liabilities) of over 1, which means that both companies are able to meet their short-term obligations. In the case of Netflix, data for this proportion has shown a stable increase during the three-year period. On the other hand Amazon suffered a more volatile tendency with current ratio increasing from 2013 to 2014, for then decreasing again in 2015. Looking at the company's balance sheet, this decrease in the ratio is due to the substantial increase in short term investments for the last period in motion.

The quick ratio (current assets – inventory / current liabilities) measures a company's ability to cover current liabilities with assets that can quickly be turned into cash. It is used as a supplementary measure to current ratio for measuring overall liquidity. If inventory is not liquid (not easily converted into cash) then the quick ratio is preferred. A quick ratio of 1.0 or higher shows adequate liquidity. Both Netflix and Amazon's quick ratio for this three-year phase are all quantities lower than 1.0, meaning that both companies don't have enough liquid assets to contrast their liabilities and therefore their current assets are highly dependent on inventory.

Debt to Equity ratio (total liabilities / stockholder's equity) demonstrates the degree to which stockholders' equity can fulfill a company's obligations to creditors in the event of liquidation. If debt exceeds equity in an organization then the creditors have more shares in a firm than stockholders. When evaluating this proportion, the smaller is the ratio the better for a company. For example in the case of Netflix, debt to equity ratio in 2015 amounted to 1.07, meaning that for every $1 owned by its stockholders, Netflix owes $1.07 to its creditors. In the case of Amazon debt to equity from 2013 to 2015 summed up to pretty high numbers, meaning that the company has been borrowing to finance its growth. Netflix on the other hand presented pretty low numbers, with 0.37 in 2013, 0.48 in 2014, and 1.07 in 2015.

3.3.2 *Profitability:*

Profitability ratios are utilized to evaluate an organization's capacity to create profit, in view of revenues generated or assets utilized. For the vast majority of these proportions, having a higher quality with respect to the same proportion from a past period is an indicator that the organization is doing great. From the table it could be perceived how Netflix has a solid balance account in terms of profitability, as a result of the successful expansion in international territory and of the introduction of new original content productions. While on the other hand Amazon's profitability since 2013 has suffered a rather volatile and unstable trend. In fact 2014 has been the worse year for the company in terms of performance, presenting negative amounts for returns on equity, returns on assets, and net profit margin. One of the main determinants to these losses in the company's financial account was due to the failure of the *Fire Phone,* which established Amazon's first attempt in the market for smartphones. The failure of this product caused the company a loss of 170 million dollars, which in consequence where added to the other 267 million net losses for the same year in motion.

Return on equity is an indicator of profitability, which denotes how much profit a company generates based on its shareholder's equity. The formula for this ratio is a percentage obtained by dividing net profit with shareholder's equity. On Netflix's account, it could be seen how the company maintained pretty high numbers for this performance measurement. ROE increased substantially from 8.4% in 2013 to 14.4% in 2014 to then decrease again to 5.5%. These rises and falls in ROE are determined by the unsteady changes in net income rather than shareholder's equity. As a matter of fact shareholder's equity has always increased for Netflix since 2013, while net income suffered an increase from 2013 to 2014 and a decrease from 2014 to 2015. Amazon instead suffered a tremendous loss in 2014, passing from a 2.8% ROE in 2013 to -2.2%. The company had to undergo to losses in 2014 due to unsuccessful investments, which in turn caused cutbacks in shares from its shareholders. In fact many shareholders decided to sell their shares to undergo the losses caused by the bad investment decisions.

Return on assets (net income / total assets) measures profit on all capital invested in the business which is used to acquire assets. This ratio eliminates the impact of the source of financing, regardless if it is debt or equity. In Netflix's business model assets primarily include subscriber's subscription fees and expenses include subscribers' acquisition costs such as marketing, and amortization of streaming content. Amazon instead, being a much larger company in terms of services provided, incurs much higher expenses compared to Netflix. Expenses for amazon include transportation costs, warehouse and storage expenses, inventory, licenses agreements, and acquisition costs. The low records obtained from both companies in this specific performance measurements, are mostly due to the significant investments that they make, sacrificing current earnings for continued growth and future payoffs.

Gross Profit Margin is a measure of how well an organization controls its expenses. It is computed as a percentage by dividing gross profit with revenues. The higher the gross profit, the better the organization is thought to control costs. Both Netflix and Amazon maintained a notable periodic increase over this three-year period, meaning that both companies were able to successfully amortize its costs. Albeit Amazon is a company that struggles in making net profits, it has always fulfilled to pay its expenses.

Operating Profit Margin demonstrates what amount of operating income a company makes on each dollar of sales. This profit measurement gives insight about the company's benefit, especially as to cost control. High working net operating profit implies that the organization has a great cost control and that sales are increasing faster than costs, which delineates a profitable solution for a company. Netflix cost is by all means expanding at a higher rate than its income, which clarifies its low operating margin. Same situation for Amazon, where high expansion costs and expenses for the development of the Prime service are outsourcing increases in profits. In fact the low percentages of 1.0% in 2013, 0.2%, in 2014, and 2.1% in 2015 mean that Amazon had just enough capital to back up its fixed costs, without producing any profit.

Net profit Margin measures the percentage of each sales dollar remaining after all costs and expenses are deducted. The formula is earnings available for common stockholders divided by sales. Companies that generate greater profit per dollar of sales are more efficient. Amazon derives a significant amount of its revenue from international operations. In 2014, the company's international sector generated 37.7% of total revenues[34]. However from the low percentages obtained for this ratio, it can be deducted that not much of this revenue could be turned into profit for the company. In 2014, Net profit margin for Amazon summed up to -0.3%, which means that to cover its costs of operations the company had to use something more than its revenues. On the other hand, Netflix had an impressive increase in revenues and net profits from 2013 to 2014, to then dropping again in 2015. 2015 was a big year for Netflix in terms of expenses, since the company introduced a new upgraded version of the platform, making content available in 4k HD.

[34] Market Line

3.3.3 Earnings Per Share (EPS):

Earnings per share is an equity performance measurement, which is obtained by dividing earnings available for common stockholders with number of shares of common stock outstanding. This ratio is used by potential stockholders to evaluate a company's earning power. Looking at Netflix's EPS data in figure 3, the company experienced an increased profit from 2013 to 2014 for consequently decreasing again in 2015. In the case of Amazon, the company experienced negative earnings per share in 2014 of -0.52 meaning that earnings for stockholders depreciated conspicuously. The difference between Netflix and Amazon's EPS is that to generate earnings (net income) Amazon requires more equity and investment compared to Netflix. The latter, being a publicly traded company, is more oriented to a stockholder's centralized model, meaning that investors have more control in the fluctuations in earnings and profits of the company.

3.3.4 Efficiency:

Assets turnover ratio measures the efficiency of a company's use of its assets in generating sales revenue to the company. A high asset turnover highlights the company's effective use of its assets to generate revenues. Netflix total asset turnover ratio shows that for every dollar of assets owned, the company generates $0.93 in 2013, $0.88 in 2014, and $0.79 in 2015 in sales. The asset turnover is decreasing regardless of its increase in revenues due to its total assets. The company is spending heavily for expansion purposes, thus on equipment and content library. In the case of Amazon is the same deal as Netflix, in the sense that asset turnover ratios are decreasing throughout the years due to substantial investments in assets. Values obtained for this ratio are 2.05 in 2013, 1.88 in 2014, and 1.78 in 2015.

3.3.4 Short-term Operating Activities:

Activity ratios indicate the speed with which accounts are converted into sales or cash inflows/outflows. Payables turnover (cost of revenues / accounts payable) is an activity ratio used to quantify the rate at which a company pays off its suppliers. This financial measurement is very important when analyzing a publicly listed company's stock for an investment opportunity, as it evidences how fast the company pays back its short-term debt obligations. Amazon has low turnover ratios meaning that it takes a longer time than Netflix to repay its creditors or suppliers. In the case of Netflix it could be seen from the chart that the turnover ratio is decreasing every year from 28.43 in 2013 to 18.62 in 2014 and finally dropping to 18.11 in 2015. The amounts aren't very low, however it means that Netflix every year is taking longer to pay off its debts and obligations.

3.3.4 Long-term Investments:

Net fixed asset turnover ratio (net sales / fixed assets) measures the efficiency of a company's use of its fixed assets when creating sales revenues. A higher fixed asset turnover ratio indicates that a company has efficiently invested in its fixed assets to generate sales revenues. It is a very helpful ratio to use for investors who want to compare companies' performances, as it indicates how effectively these companies arrange their operating activities. Netflix's net fixed asset turnover ratio has periodically increased from 2013 to 2015, as a result of an improvement in both net sales and fixed assets. Taking into consideration the dimension of Amazon's services, the company presents promising values for this performance measurement. This can be depicted from the business model of the company, which is basically concentrated in the retailing of products. Therefore the company targets its fixed assets, property, plants, and equipment as one of the main sources of revenues.

Equity turnover (net sales / avg. total equity) measures a company's capability to generate profits and sales throughout investment in equity. The higher the ratio the better as it means that the company is effectively using its capital. Amazon shows pretty high and stable ratios for equity turnover, with results of 7.64 in 2013, 8.28 in 2014, and 7.99 in 2015. An equity turnover of 7.99, for example, means that for every dollar invested in equity, the company obtains revenue of $7.99. So as it can be clearly denoted, Amazon extracts important amounts of revenues from its shareholder's equity, moreover permitting the company to proficiently target long-term investments. Netflix as well as Amazon can count with an important base of shareholder's equity. Ever since landing in the market for online streaming services, Netflix has had as a main objective, the expansion of the platform in international territory. As a matter of fact in 2015 revenues increased from $5,504,656 to $6,779,511, thanks to higher returns on sales and increased number of subscriptions outside the United States.

Now with all the analysis at hand a clearer image of what are Amazon and Netflix's performances in the market can be perceived, and an ex-post evaluation can be given. It is true that both companies, with their online streaming platforms, compete in the same market, but however a comparative financial position analysis can be made just until a certain extent. Amazon as a whole has a different target and business model respect to its competitor. The Seattle based company targets three different market segments, which are: *Media, Electronics & General Merchandise, and other,* which is mostly occupied by its web service (AWS), generating significant amounts of revenues but almost no net profit. In fact Amazon's view and paradigm for the market is the one of keep investing, seek new opportunities and keep targeting new market segments, because to take profit out of the business would be to waste opportunities that the industry can reserve[35]. In addition, thanks to the company's increased revenues and solidified business ideal, the CEO Jeff Bezos continues to attract investors to invest money into his company, with the expectation that at some point Amazon will control not only the e-commerce market, but a whole new market segment. Netflix on the other hand, is a much smaller organization, but with a consolidated business ideal. In fact, its solid financial performance in terms of profitability, liquid, efficiency, and equity, are all a testimony of why the company is one of the leaders in the market in which its serves. Its international expansion, its increasing number of subscribers, and the constant development of its streaming platform with the periodical addition of original content, has been the basis and main source of its profits.

[35] http://ben-evans.com/benedictevans/2014/9/4/why-amazon-has-no-profits-and-why-it-works

Conclusion

In conclusion this thesis attempts to give a complete overview of Netflix as company. The first chapters serves as an introduction of Netflix's background and history, starting as provider for DVD rentals, to end up as one of the leaders in the market for online streaming services. The second chapter focalizes on a financial position analysis of the company, discussing the relevant key ratios adjacent to company's balance sheet and income statement. Finally the third and last chapter followed a more comparative approach, putting into comparison Netflix's financial performances with its main competitor Amazon.

Netflix has figured out how to keep up enduring development through the years and accomplish an increasing level of profit. The company has accomplished this by permitting its customers to access a wide variety of content, specifically attached to their preferences. Increasing consumer trends, and seeking new opportunities around the globe, has additionally helped Netflix to establish itself as one of the main service provider for online streaming contents. The test for Netflix is to increase rates of return. Without a larger amount of profits, Netflix leaves itself vulnerable against aggressive competitors who have a more elevated amount of capital and financial backing that it does. The company will take time to amortize recent worldwide expansions, however the continuous forcing of this implementation will eventually prove to be a success for the company's account and name. Benefiting from other solid economies such as Germany, France, and Australia ought to be the center for Netflix in spite of the fact that this will collect high initial costs, which will influence levels of profitability.

The significance of getting and holding content is crucial to guaranteeing that Netflix turns into a worldwide leader in the online streaming sector. The monetary support of its opponents is a risk and threat to this as HBO and Amazon have both possessed the capacity to outsource Netflix for content. This could turn out to be a significant downturn to Netflix's development, as it would guarantee losses in subscribers, and thus losses in revenues. Be that as it may, spending capital on content is an absolute necessity to keep hold of existing clients. A huge positive factor for Netflix has been the accomplishment of the original content it has delivered and made accessible solely to its clients. Original content will have made a commitment to subscription numbers and this has prompted Netflix deliberating more revenues to the production of new original content.

It is clear that to keep on growing, Netflix needs to keep on investing in different parts of the business which will see its net revenues increment as past investments start to turnaround. Inability to do as such may prompt opponent organizations such HBO and Amazon to exploit new opportunities in an always more fearful market.

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Source: Business-Management-Degree.net

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