

# ***Navigating the Streaming Wars: A Financial and Risk Assessment of Netflix's Position and Prospects***

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**Abstract:** This paper provides an in-depth financial and risk assessment of Netflix, Inc., analyzing its competitive positioning in the rapidly evolving streaming industry. Key financial indicators such as revenue growth rate, net profit margin, return on equity, and earnings per share growth are used to evaluate Netflix's profitability and overall financial health. The study also examines the risks Netflix faces, including heightened competition from Disney+, HBO Max, and Amazon Prime Video, as well as operational and cybersecurity vulnerabilities. Despite these challenges, Netflix continues to innovate through strategies like an ad-supported subscription model and heavy investments in original content production, which bolster its global expansion. The findings indicate that while Netflix remains a dominant player in the streaming market, its long-term success is threatened by increasing content production costs and intensified market competition. This paper offers valuable insights for investors and stakeholders seeking to understand Netflix's financial outlook and strategic responses to these risks in an increasingly competitive environment.

**Keywords:** Netflix, financial analysis, investment analysis, risk analysis.

## **1. Introduction**

Netflix, a pioneer in the global streaming arena, has revolutionized our approach to entertainment consumption. Established in 1997 by Reed Hastings and Marc Randolph, the company began as a DVD rental service and transitioned to a subscription-based streaming service in 2007. This pivotal shift placed Netflix at the vanguard of the digital entertainment evolution, garnering a vast audience and experiencing significant revenue expansion.

Yet, Netflix's dominance in the market has faced stiff competition with the emergence of rivals like Disney+, HBO Max, and Amazon Prime Video. Nevertheless, Netflix has sustained its advantage through relentless innovation and strategic moves, such as launching an ad-supported plan to appeal to cost-conscious viewers [1].

Investment in Netflix stock has proven lucrative for early believers in the company's vision, with returns exceeding 43,300% over two decades [2]. Despite recent market fluctuations, Netflix's long-term growth prospects remain promising, underpinned by its global reach, content production capabilities, and strategic adaptability.

In conclusion, Netflix's background as a pioneering streaming service, its financial performance, and its strategic initiatives to counter competitive pressures make it an interesting case study for

investors considering its potential as an investment. While the streaming market is becoming more saturated, Netflix's established brand, content library, and ongoing investment in original programming continue solidifying its position as a major player in the entertainment industry.

This research will analyse whether Nifty is worth investing in, using data and risk factors to give investors an idea and an opinion from the financial aspect.

## 2. Company Introduction

Netflix was founded in 1997 by Reed Hastings and Marc Randolph and is headquartered in Los Gatos, California. The company's original business was the rental of video discs by mail, using an online subscription model that allowed consumers to rent films unlimited times with no late fees for extended returns. Over time, Nerf has evolved into the world's leading Internet streaming entertainment service, offering a wide range of entertainment content, including movies, TV shows, and documentaries, and operating through U.S. and international geographic divisions. The company's corporate culture emphasises "freedom and responsibility", encouraging innovation and exploration within a clear framework of responsibility, as well as each employee's personal investment and commitment to the company's success. This culture not only stimulates the creative potential of employees but also gives the company an edge in the competitive marketplace. Netflix's success lies in its business model, innovation, focus, and investment in content. Through disruptive innovations, such as simplifying the rental process and breaking the traditional rental model, the company gradually became the leader in the DVD rental industry and eventually developed into the world's leading streaming media service provider.

## 3. Method Introduction

### 3.1. Ratio analysis

This article uses the ratio analysis method to analyse a company's financial performance using the P/E ratio, Net profit margin, Gross profit margin, EPS (Earnings per share) growth rate, Revenue growth rate, ROE, and PEG ratio.

#### 3.1.1. Revenue growth rate

Revenue growth rate measures a company's ability to grow its revenue over a certain period, reflecting the expansion and growth of the company's business [3]. (Equation (1)) By looking at the revenue growth rate, it is possible to determine whether a company is in a growth, stabilisation or decline phase, which is essential for assessing the overall health of a company and its competitiveness in the market.

$$\text{revenue growth rate} = \frac{\text{NTM Revenue growth rate}}{\text{TTM Revenue growth rate}} - 1 \quad (1)$$

#### 3.1.2. Net profit margin

The net profit margin indicates the proportion of sales revenue that remains after accounting for all expenses, including interest, taxes, and preferred stock dividends. Consequently, a company boasting a robust NPM (Net Profit Margin) can be deemed financially sound [4]. The calculation for net profit margin is presented in Equation (2).

$$\text{Net profit margin} = \frac{\text{EAT}}{\text{Net sales}} \times 100\% \quad (2)$$

### 3.1.3. Gross profit margin

The gross profit margin (or gross profit rate or ratio) is a profitability metric showing the percentage of total sales' gross profit [5]. The formula for gross profit margin is in Equation (3).

$$\text{Gross Profit Margin} = \frac{\text{Net Sales} - \text{COGS}}{\text{Net sales}} \quad (3)$$

### 3.1.4. Earnings per share growth rate

EPS (Earnings per share) growth rate reflects the growth of a company's profit per share and is an important indicator of the growth of a company's profitability. (Equation (4)) A higher EPS growth rate usually means that a company's profitability is increasing, which is conducive to boosting the company's share price and investor confidence [6].

$$\text{EPS growth rate} = \frac{\text{NTM EPS}}{\text{TTM EPS}} - 1 \quad (4)$$

### 3.1.5. P/E ratio

While the P/E ratio might appear to gauge the magnitude of investors' anticipated returns on their investments, its interpretation is more nuanced. The price-to-earnings ratio is an indicator of the optimism investors hold regarding a company's potential for growth; it signifies the anticipated rate of return on the investment opportunities the company possesses, as well as the extent of their reinvestment rates. Further examination of the EBO model reveals that the P/E ratio is contingent upon the variance between the expected excess returns in one period and those in the subsequent period. Investors should consider several factors when utilizing the P/E ratio: if the EPS (Earnings Per Share) in the P/E calculation is based on the most recent accounting period, the ratio could yield misleading results during economic cycles or periods of inflation; the P/E ratio should be evaluated in tandem with other financial metrics; and there are limitations to the comparability of P/E ratios across different entities [3]. The formula for calculating this ratio is detailed in Equation (5).

$$\text{Price Earnings} \left( \frac{P}{E} \right) \text{ ratio} = \text{stock} \frac{\text{price}}{\text{earning per share}} \times 100\% \quad (5)$$

### 3.1.6. Return on Equity

ROE, or return on equity, is a financial metric that assesses a company's profitability, revealing the extent to which a company can generate earnings from the funds provided by its shareholders [7]. This ratio is determined by dividing a company's net income (or profit) by the equity of its shareholders and is commonly presented as a percentage. (Equation (6))

$$\text{ROE} = \frac{\text{Net Income}}{\text{Shareholders' Equity}} \times 100\% \quad (6)$$

### 3.1.7. PEG ratio

PEG (Price Earnings Ratio to Earnings Growth) is a metric for valuing stocks calculated by dividing a company's Price Earnings Ratio (PE) by the company's earnings growth rate, as shown in Equation (7). Therefore, this ratio considers a company's expected future earnings growth and is more comprehensive than the price-earnings ratio (PE) alone. PEG values are often used to compare the valuation levels of different stocks or changes in the valuation of the same stock at different points in time.

$$PEG = TTM \frac{P}{E} \div (100 \times EPS \text{ growth rate}) \quad (7)$$

## 3.2. Risk analysis

Financial risk specifically refers to the potential risk of loss faced by enterprises investing in financial products in the financial market. This risk stems from the inherent uncertainty and complexity of the financial market and can be divided into the following main types [8].

### 3.2.1. Market risk

Market Risk refers to the potential for financial loss arising from volatility in market prices, often influenced by shifts in economic indicators, investor psychology, and broader market dynamics. This type of risk impacts a diverse array of assets such as equities, fixed income instruments, and commodities. It is a pivotal factor for both corporations and investors to take into account when formulating their strategies. Gaining insight into market risk is essential for the successful management of financial risks and the development of strategic plans [9].

### 3.2.2. Credit risk

The firm is exposed to two principal categories of credit risk: default risk and credit spread risk. Default risk denotes the probability that a company will fail to meet its financial obligations, leading to a financial loss for the party on the other side of the transaction. Conversely, credit spread risk pertains to the potential losses that can occur as a result of fluctuations in the market value of a company's debt, which are triggered by alterations in its credit rating or its capacity to fulfill its obligations.

### 3.2.3. Operational risk

Operational risk encompasses the potential for financial loss stemming from deficiencies or breakdowns in internal procedures, personnel, technology, or from external incidents. This category includes legal risks but excludes strategic and reputational risks. Operational risk covers a broad spectrum of potential losses that may arise from human mistakes, system malfunctions, fraudulent activities, and other unforeseen events unrelated to market movements or shifts in a company's strategic direction. It is a significant factor for financial institutions and forms a central part of the Basel II Accord, which establishes regulatory guidelines for capital adequacy and risk management practices [10].

## 4. Analysis

### 4.1. Data Analysis

Netflix's revenue growth rate is 13%. A thirteen percent earnings growth rate for a company indicates that the company's earnings in a given period have increased by 13% compared to the previous period. This is usually a positive sign that the company's sales have improved.

The net profit margin is 16%, calculated by Equation (2). A company with a net profit margin of 16 per cent can retain 16 cents of every dollar of revenue earned as net profit after all operating costs, interest, taxes and other expenses are deducted. It also indicates that the company is performing well in financial management and cost control and can effectively convert revenue into net profit. A company's net profit margin can provide insight into its strategic decisions and their impact on profitability. For example, a company that invests heavily in research and development may have a

lower net profit margin in the short term but may achieve higher profitability in the long term through innovation and market leadership.

The gross profit margin is 41.5%, calculated using Equation (3). If a company has a gross profit margin of 41.5%, this means that after deducting costs directly related to production and sales (e.g. raw materials, direct labour costs), it can retain 41.5% of its total revenue as gross profit. A higher ratio usually indicates that the company is managing its cost of goods sold, can sell its products or services at a higher price, or is more efficient in its production process. A gross profit margin of 41.5% is usually considered a healthy financial indicator, showing the company's efficiency and profitability in its core operations. However, whether this figure is "good" or not needs to be judged based on industry standards and a company's specific business model. For example, the average gross margin of some industries may be much higher or lower than 41.5 per cent, and therefore, companies often compare their gross margins with those of other companies in the same industry to assess their competitiveness.

The TTM EPS growth rate is 16, and the NTM EPS growth rate is 20.82; these results are calculated by Equation (4), and Table 1 illustrates the needed numbers.

Table 1: Netflix EPS now and in recent quarters

Quarter	-3	-2	-1	0	1	2	3	4	TTM	NTM
EPS	3.73	2.11	5.28	4.88	5.08	3.89	5.98	5.87	16	20.82

When a company experiences an increase in its TTM (Trailing Twelve Months) Earnings Per Share (EPS) growth rate from 16% to an NTM (Next Twelve Months) EPS growth rate of 20.82%, it typically suggests that the market anticipates an acceleration in the company's earnings growth in the forthcoming year. Based on the Price-Earnings Ratio (P/E Ratio) definition, if a company exhibits a lower P/E ratio compared to its industry peers, the market might view its stock as undervalued, potentially leading to a rise in stock price. However, Netflix's P/E ratio is notably high.

With a TTM P/E ratio of 41.88 and an NTM P/E ratio of 32.18, Netflix's P/E ratio has decreased, signaling that the market has revised its expectations for the company's future earnings. A reduction in the P/E ratio often implies that the market foresees an increase in the company's future profitability. If investors anticipate earnings growth, they might be inclined to purchase the stock at a lower P/E ratio, as they expect an increase in EPS, which could lead to higher returns. Fluctuations in the P/E ratio can also mirror shifts in market sentiment. Optimistic sentiment about a company's future can boost its stock valuation, resulting in a lower P/E ratio. Conversely, investor sentiment can influence the P/E ratio in the short term, with optimism potentially elevating the P/E ratio and pessimism potentially depressing it.

As of June 30, 2024, Netflix's ROE is 14.47%, and it rises to 32.09% as of September 20, 2024. The PEG ratio stands at 1.39. An ROE of 32% indicates that the company can generate 0.32 units of net profit for each unit of shareholders' equity, which is generally considered an indicator of profitability. However, it's crucial to recognize that an exceedingly high ROE can sometimes mask excessive financial risk, particularly if such high returns are derived from high leverage. A PEG ratio close to one suggests that the company's growth is stable.

## 4.2. Risk Analysis

### 4.2.1. Market Risks

Competition in the market is Netflix's main market risk. With large media companies like Disney and Amazon launching their streaming services, Netflix's market share is being challenged. The strategies of new entrants and existing competitors may affect Netflix's subscriber growth and

subscription revenues. Within the competitive sphere that Netflix inhabits, two core methods exist to entice new audiences and solidify the allegiance of current subscribers. The initial strategy revolves around product differentiation, specifically the diversity of content accessible on the platform. Should Netflix present a platform that boasts a more extensive content library than its rivals, yet at a barely distinguishable price, it is logical to deduce that consumers will gravitate towards the option that provides enhanced value for the same cost? An additional strategy to draw in newcomers and maintain the fidelity of existing patrons is to offer the product at a lower cost than that of competitors, naturally, with the assumption of comparable quality. Despite Netflix's expansive international presence, spanning operations in more than 190 countries, as previously highlighted in the PESTLE analysis concerning legal elements, the restriction on broadcasting the complete content suite in 130 nations poses a risk of ceding market share to competitors active within those territories [9]. In addition, Netflix's international expansion strategy is challenged by local cultures, regulations and competitive environments, which may limit its growth potential in the global market.

#### 4.2.2. Credit Risk

Netflix's credit rating has improved in recent years, indicating an improvement in its credit profile. However, its credit ratings may suffer if the company cannot maintain its strong financial position or market expectations of its future profitability decline. A decline in credit ratings may result in higher financing costs, affecting the Company's debt management and financial strategies. Netflix is expected to reduce its membership by more than 2 million, and it has started laying off employees and cutting expenses. This indicates that there has been a slowdown in Netflix's subscriber growth, which is one of the key metrics to measure Netflix's success.

#### 4.2.3. Operational Risk

Cybersecurity risk is a subset of operational risks. It signifies the possibility of exposure or financial loss due to cyber-attacks or data breaches within an organization. It can also refer to potential damage or loss linked to the technical infrastructure, technology utilization, or the organization's reputation.

The unauthorized distribution of content on unauthorized streaming platforms is a clear violation of copyright laws. Netflix likely possesses some of the most sophisticated cybersecurity measures in the industry, which is crucial for safeguarding its proprietary content that underpins its revenue stream and relies on major releases to sustain customer engagement. However, the security vulnerabilities of third-party collaborators pose a significant threat to its cybersecurity defenses. A case in point is the partnership between Netflix and Larson Studios. In 2017, 10 new episodes of the hit Netflix Original series "Orange Is the New Black" were leaked following a cyber-attack on the post-production company, Larson Studios [11].

In conclusion, Netflix must adeptly manage these risks while continuing to grow and preserve its dominant market position. By broadening its content offerings, refining its pricing strategy, bolstering its technological infrastructure, and improving the user experience, Netflix can enhance its risk mitigation capabilities and retain its competitive advantage in the streaming media sector.

## 5. Conclusion

Netflix has over 230 million subscribers worldwide, demonstrating its broad market acceptance and brand loyalty. The Company's investment in original content production, such as Stranger Things and House of Cards, has proven to attract and retain subscribers while enhancing brand image. The Company has also demonstrated its global growth potential with its expansion strategy in international markets, particularly in non-English speaking countries with high broadband penetration and mobile-dominated countries. It has yielded significant results, such as simultaneous launches in

130 countries. The various figures calculated above also show Netflix's strength and stability. Despite Netflix's leading position in the streaming industry and its strong global brand presence, investors should also be aware of potential risks such as increased competition in the market, rising content costs, and uncertainty in international markets when considering an investment. By doing so, the investors can provide a comprehensive perspective that recognises Netflix's achievements without ignoring the challenges it faces.

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