My failed April Fools' post $NFLX

I spent the morning trying to write a combo April Fool's post / prank*. I've put the summary of the idea in the footnotes if you're interested in it; ultimately I decided not to finish / post the article. But spending time on the article did get me thinking about April Fool's and investing, and it reminded me of this April Fool's post on Barel Karsan (a site and author I very much enjoy; that I could remember a post from 7 years ago should speak to that).

The post was a mocking one suggesting an investment in Netflix based on P/E several years out, low beta, and the company basically conquering the world. The comments (always a dangerous section to read) are particularly interesting; several readers say they thought the author had lost his mind, one reader says he was ready to remove the blog from his reader before realizing it was a joke, and another mentions that the Tilson fund has recently closed their short in the stock and sees that as a sign of capitulation that suggests now is the time to short.

Here's the stock price since that article mocking Netflix came out:

Anyway, hindsight's 20/20, and I'm certainly not linking to the article to call the author out specifically. I'll openly admit that when I read the article I was in open agreement with it, and at the time that type of "it's crazy expensive" thinking held a lot of weight with me (I was just starting as an investor, and I remember being on some email threads with other "value" investors that basically talked about shorting the over-priced and over-hyped Amazon and waiting for Walmart to kill them. Amazon's share price since then looks a lot like Netflix).

So the real reason I'm linking to the post is because it's interesting to look at the short / prank case in hindsight and see what we can learn from it.

- **The P/E argument:** Netflix was trading at ~80x P/E, causing a lot of investors to argue it was massively overvalued. Today, investors are a lot more understanding that companies growing rapidly and investing their profits into growing their customer base / scale can create massive value, and you really do need to look at future valuations for companies that fit that mold.
- **The already at 20m subs / can't grow to the world population approach**- I remember a big piece of the short thesis with Netflix was that Netflix was already approaching the limit of where their subs could go (if I remember correctly, I think some people would mention that subscription services like newspapers / magazines had historically topped out at ~30m subs and Netflix would hit a wall as it approached that number). In hindsight, it's a bit laughable to think that 30m subs was the wall for Netflix (a comp to "old economy" sectors seems insane given the clear scale benefits and the ease / quickness / 0 marginal cost of each additional sub); with hindsight, the really breathtaking thing is thinking that Netflix was already at 20m subs in 2011 (almost all were domestic) and a lot of us weren't already seeing just how big the potential of the streaming platform was; today, HBO streaming has just 5m customers (to be fair, that's a bit apples to oranges since it doesn't include HBO's cable subscribers), so that Netflix was already so scaled out in 2011 is just wild.
- **The content is expiring / competition is coming argument**: The NFLX prank post was written ~2 years before Netflix premiered House of Cards and really got their original content business going. Obviously it's impossible to forecast that at the time, but I do think it shows with hindsight how easy it was to underestimate the advantages Netflix's data / subscriber numbers gave them against the legacy players or potential new entrants.

Going back and thinking about that post again reminded me a lot of the takeaways from the Bill Nygren interview I linked to back in February: in the past, low P/E stocks dominated for value investors, but today when you're looking for value / outperformance (particularly in compounders), a big piece of the process is finding value in qualitative things that the market has yet to recognize / value properly. Today, the market has probably figured out the "scale platform" advantage and is getting better at valuing those, so the trick is probably going to be either identifying sources of scale / platform advantages that the market hasn't picked up on yet (for example, recognizing Tinder's moat two years ago when the market thought the online dating sector had no moat and Tinder would never monetize (stock up ~4x since then), or recognizing that digital delivery and micro transactions would be a huge boom for the video game companies when the market thought casual gaming might destroy them (most video game companies are up ~2-3x since)) or finding the next thing that is "new" that the market doesn't know how to value (like scalable tech platforms were ~a decade ago).

Buffett's famously said that he could make you a better investor if he gave you a punch-card and you could only make ten or twenty investments in your life time. For a long time, I believed that line was all about price discipline (i.e. the punchcard made you only invest during a financial crisis when everything was a screaming bargain). Maybe that's a piece of it, but as I continue to learn I think a big part of the punch card thought process is actually to just always be out there learning and reading and trying to find that one **qualitative** thing that you know is going to be crazy valuable but the market doesn't know how to value, and that when you find that thing you need to swing really hard.

One more thing about that Buffett quote: I've heard it dozens of times since I started investing about ten years ago, but as I sat down to write this post I'm still gleaning something incremental from it. One of the craziest things about being an student of any industry is how you continue to find new wisdom in decades old quotes and ideas as you learn and mature.

*For those still reading / interested in what the April Fools' idea was: the gist of the idea centered on the Sohn Conference idea contest. David Einhorn and Bill Ackman are both judging it, and with both of their public vehicles (GLRE and PSH, respectively) trading well below book value, the write up and enter an idea centered on an activist pitch on both companies. The write up would be completely blind to the fact that the fund managers there were also the idea conference judges; instead, it would highlight their persistent under-performance and high fees. The refusal to get serious about repurchasing shares at a big discount to book (likely driven by the conflict of interest to keep management fees high) played a big role in the article, as did the $290m Allergan payment. Ultimately I decided not to post it: entering the ideas into Sohn would run $200 which I didn't feel like spending, and there tends to be a fine line between humor and being a mean internet troll, and my writing can edge on the dry side when I try to be funny so I was worried I was pushing closer to the "mean internet troll" category than I meant to (I generally have learned from and like both of them, though I don’t know either personally, so I certainly didn’t want to be a mean internet troll!).