Following the money: What Carl Icahn sees in Netflix

Curator Paul Sweeting | Thursday, November 1, 2012 | Join the Discussion |

If he hasn't watched it already, Netflix CEO Reed Hastings should listen closely to the interview billionaire corporate raider Carl Icahn gave Bloomberg TV yesterday about the reasons behind his acquisition of nearly 10 percent of Netflix's outstanding shares. Then he should check out this piece in the Harvard Business Review ($$) written last year by former Blockbuster CEO John Antioco recounting his own, losing tussle with Icahn for a refresher course on Icahn's capacity for tormenting CEOs, particularly those making expensive long-term strategic investments at the expense of short-term earnings.

Icahn got involved in Blockbuster just as Blockbuster was trying to acquire rival Hollywood Video to consolidate the then-over built video rental store market. Icahn actually bought both sides of that proposed deal in an arbitrage play. But when the FTC ultimately scuttled the merger Icahn's bets crapped out. He then turned his attention to Blockbuster's strategic plan (along with Antioco's compensation).

At the time, Blockbuster was spending heavily to build Blockbuster Online in response to the rise of Netflix, and had made a strategic decision to eliminate late fees — a major chunk of Blockbuster's cash flow but a major irritant to customers, who now had an alternative in the subscription-based payment model pioneered by Netflix.

Having lost his bet on the Hollywood deal, Icahn needed another way to get his money back. And the cash Blockbuster was sinking into building its online operation and eliminating late fees was the obvious place to look. To get it, Icahn launched a proxy fight, took control of Blockbuster's board, forced out Antioco and brought in a new CEO, Jim Keyes, who shutdown spending on the online business and reinstated late fees.

As it turned out, even if those moves by Keyes had made sense (doubtful in my view) they came too late. Blockbuster filed for bankruptcy two years later. Icahn now calls Blockbuster "the worse investment [he] ever made."

Like Blockbuster under Antioco, Netflix under Hastings is spending heavily on its international expansion plan in an effort to respond to growing domestic competition. That spending is depressing near-term cash flow and driving down the value of Netflix's stock (making it cheap enough for Icahn to accumulate his 10 percent stake). In his interview with Bloomberg, Icahn repeatedly mentioned Netflix's domestic cash flow, which he pegged at $2.5 billion, and suggested it wasn't being properly valued by the market, in part because it was being obscured by the negative cash flow coming from overseas.

Icahn is clearly betting he can force Netflix into a sale that will produce a windfall for his stake. But if that doesn't work (and there are a lot of doubters) he will almost certainly go after the cash Hastings is now spending in Latin America and Europe. And if Hastings tries to stand in his way because it would harm Netflix's long-term prospects...well, just

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