DIXON MITCHELL INVESTMENT COUNSEL

# DM MONTHLY REPORT

December 2022

## PORTFOLIO ACTIVITY

In November, we liquidated our position in Open Text Corp. and added this capital to our weight in Kinaxis Inc. Accumulated cash was also used to increase our allocation to Brookfield Asset Mgt.

## FEATURE STOCK

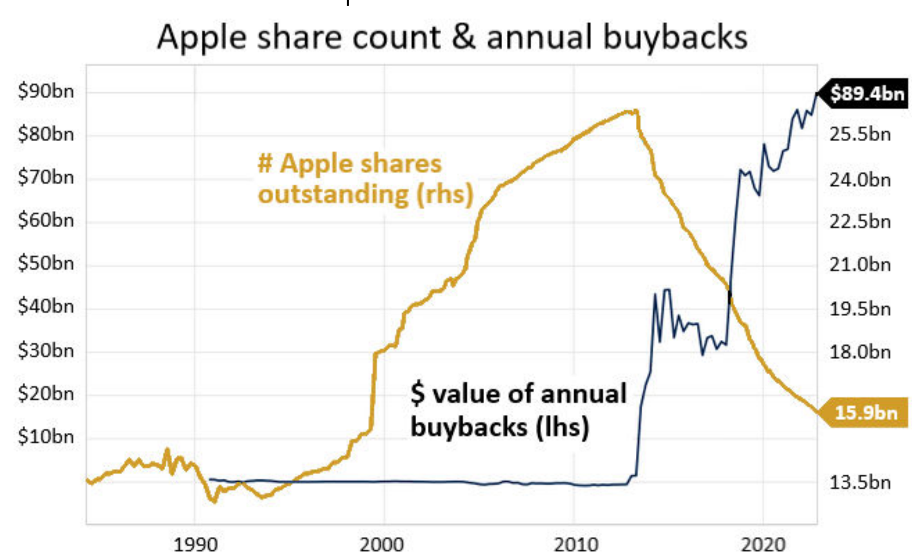
**Netflix Inc. (NFLX)**

We first added NFLX to the DM US Equity Portfolio at the end of this year's first quarter after the stock had fallen by roughly half from its recent high. At the time, we were glad to get the global leader in streaming at a big discount to where it had traded just weeks before. In particular, we liked the scale advantage enjoyed by the company, especially with respect to the production of original content, and the fact that it was on the cusp of becoming self-funding through the redeployment of internally generated cash flow. Unfortunately, it's subsequent earnings release was weak, especially with respect to subscriber levels and password sharing, and the stock fell further. This setback spurred management to establish a two-tiered service, with a lower price point offered to those who were willing to accept advertising with their subscription. Though NFLX had previously resisted such a move, co-CEO Reed Hastings realized that the lucrative 18-49 demographic had moved from linear TV to streaming, representing a huge opportunity for ad sales. Over the past six months, the stock has responded to this change, rising by more than 60%.

## *SHARE BUYBACKS, DONE RIGHT*

Assessment of a company's ability to generate and grow cash flow represents a fundamental pillar in DM's equity evaluation framework. Identifying these portfolio candidates is just the start of our process, however, with much of the heavy lifting devoted to evaluating how management plans to deploy excess capital to create additional shareholder value over time. One of the ways that a company can put cash flow to work is by purchasing its own shares in the market and then retiring them. If done properly, buybacks will shrink the "pie" of outstanding stock, causing the slices owned by remaining shareholders to become relatively larger. This favourable outcome doesn't always happen, though, and several buyback programs have been met with complaints that the shares retired are more than offset by those created via generous options programs for senior employees. Because of this potential "agency" problem, it is imperative that we look beyond a repurchase announcement to ensure that capital spent will actually benefit the company's owners, and not simply represent a hidden wealth transfer to corporate management.

The gold standard for buybacks is Apple Inc., which began retiring shares about a decade ago (black line on chart below). Over that time, the company has spent more than $550bn on stock repurchases, which has caused share count to fall by about 40% (gold line). As well, according to Apple, it's paid about $47 per share on average over this time, which compares very favourably with the stock's current price of approximately $145. Another way to gauge the effectiveness of this activity is to compare aggregate with per-share profitability and, on this count, Apple also scores very well. Over the past decade, the company's total annual cash flow has increased by about 2.7 times, while its cash flow per share has more than quadrupled. Though dividends are a more visible way to return capital to shareholders, a well-run buyback program that puts owner interests first can also be a powerful wealth creator.



Source: *Bloomberg*

Suite 1680, 1055 West Hastings St, Vancouver, BC V6E 2E9 +1 604 669 3136 Toll Free: +1 888 340 3136 DM dixonmitchell.com