Investors remain leery of Netflix 1 year after video service's price increase irked customers

By MICHAEL LIEDTKE AP Technology Writer

SAN FRANCISCO (AP) -- Netflix is more popular among couch potatoes than investors a year after its polarizing decision to raise U.S. prices for video subscription services.

The unexpected twist that Netflix unveiled a year ago Thursday triggered mass customer cancellations and a sell-off in its stock, which has wiped out more than $11 billion in shareholder wealth.

Netflix Inc. has bounced back this year to revive its subscriber growth. But even after a recent rally, its stock remains more than 70 percent below its peak price of nearly $305 about a year ago, largely because of concerns about what Netflix has been spending to attract and retain subscribers. The stock gained $3.33, or 4 percent, to close Thursday at $84.97.

The company increased its prices by as much as 60 percent as part of an effort to phase out its DVD-by-mail rental service and raise more money to license TV shows and movies for its Internet video library.

Preparing for the day when DVDs become obsolete makes good business sense as the ubiquity of high-speed Internet connections makes it easier and more convenient to watch video online. Promoting Internet streaming over DVDs also helps Netflix save money on postage as it mails fewer discs.

But DVDs still appeal to subscribers who want to watch the latest movie releases. That's because studios generally have refused to license their more recent material for online viewing, leaving Netflix's Internet video library with a less comprehensive selection than what's available on DVD.

The shortcoming wasn't a problem until last year because Netflix had been bundling DVDs with unlimited video streaming in a package that cost as little as $10 per month. With the price change, Netflix split video streaming and DVD rentals into separate services that raised the monthly minimum cost for both to $16.

As if the higher prices weren't aggravating enough, Netflix CEO Reed Hastings infuriated subscribers even more a couple months later with a ham-handed apology that dropped another bombshell: The company intended to spin off the DVD service into a separate website called Qwikster. That switch would inconvenience subscribers who still wanted both DVDs and Internet streaming by requiring them to maintain two separate accounts on different websites.

The ensuring uproar caused Hastings to quickly scrap Qwikster, but by then the damage had been done.

Netflix lost 800,000 U.S. subscribers during the quarter spanning the price hike and the Qwikster announcement, but the company has since bounced back from that setback. As of March 31, Netflix had 26.1 million U.S. subscribers, more than the 24.6 million the company had just before the price hike was announced. The bulk of those subscribers now pay only for Internet streaming.

Just as Hastings envisioned, the streaming service is becoming increasingly addictive as Netflix adds more titles.

Netflix, which is based in Los Gatos, Calif., says its streaming subscribers worldwide watched more than 1 billion hours of Internet video in June. That translates to a monthly average of about 38 hours per subscriber, up from 28 hours late last year. Netflix's commercial-free Internet video library now gets watched more frequently than most TV networks, which depend on ads and cable fees.

Despite the popularity, Netflix hasn't proven that it will be able to make as much money streaming video over the Internet as it has delivering rented DVDs through the mail during the past decade.

Internet video hasn't been as profitable so far primarily because Netflix has had to spend heavily to secure the licensing rights to show movies and TV shows online whenever subscribers want to watch them. The popularity of streaming could prompt movie and TV studios to demand even higher fees.

As of March 31, Netflix had signed contracts that will require the company to pay $3.6 billion in licensing rights during the next five years, including $730 million by next April. Netflix ended March with about $800 million in cash.

The obligations have been piling up so quickly that Netflix expects to post an annual loss this year, the first time that has happened since 2002. Netflix will release its second-quarter results on July 24.

"Smart people question whether they will ever make money," Pachter said of the challenges facing Netflix in streaming. "Netflix is growing unprofitably, and content owners who see usage (of video streaming) go up by 50 percent are either going to charge more or offer lower quality content. Either is a drag on the stock."

Pachter said he is wondering if Netflix's stock might even fall below the $45 price target that he has set for the shares.

Citigroup analyst Mark Mahaney said the concerns about Netflix are overblown, although he doesn't expect the stock to return to its previous high any time soon. He believes Netflix shares could reach $130 within the next year.

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