Higher Netflix prices equals fewer subscribers

September 15 2011, By MICHAEL LIEDTKE , AP Technology Writer

In this April 22, 2011 file photo, the logo of Netflix is displayed at the headquarters in Los Gatos, Calif. Netflix is lowering its U.S. subscriber expectations for the third quarter because of customer losses relating to a split of its DVD and streaming options. (AP Photo/Paul Sakuma, File)

Netflix's decision to raise prices by as much as 60 percent is turning into a horror show.

The customer backlash against the higher rates, kicking in this month, has been much harsher than Netflix Inc. anticipated. That prompted management to predict Thursday that the company -the largest U.S. video subscription service- will end September with 600,000 fewer U.S. customers than it had in June.

It will mark just the second time in 12 years that Netflix has lost subscribers from one quarter to the next. The last downturn occurred during 2007 when Netflix lost a mere 55,000 from March through June.

The current hemorrhaging exacerbated fears that Netflix is losing the magic touch that increased its stock 10-fold in the three years leading up to the company's July 12 announcement about its higher prices.

Since then, Netflix has turned into Wall Street's equivalent of a box-office flop. Its shares plunged $39.46, or about 19 percent, to close at $169.25 on Thursday, leaving Netflix's stock price more than 40 percent below where it stood before the company unveiled the higher prices. The cost to shareholders so far: more than $6 billion in paper losses.

It could get uglier if the worst-case scenarios play out. Netflix suffered another setback earlier this month when Starz Entertainment ended talks to renew the licensing rights to a key part of Netflix's video library for streaming over the Internet. The fallout from that decision will hit in March when Netflix will no longer be able to stream the popular mix of recently released movies and TV shows that it got from Starz, raising the specter of another onslaught of customer defections.

"Netflix isn't looking like it's as good a deal because their prices are getting higher and their content isn't getting any better," said Wedbush Securities analyst Michael Pachter, who thinks the company's shares could fall as low as $110. "It's like they have taken the beef away from the buffet."

The customer exodus still hasn't convinced Netflix to reverse its course and lower its prices as it did in 2007 when it was engaged in a cut-throat battle with Blockbuster Inc. In announcing its lowered subscriber forecasts Thursday, Netflix emphasized it consider its new prices to be "the right long-term strategic choice."

The new pricing structure was driven by Netflix's desire to build up its service that streams video over high-speed Internet connections, even at the risk of hurting the DVD-by-mail rentals that used to be its main business. Netflix management believes the convenience of Internet video is the main reason that it has added 17 million U.S. subscribers during the past three years, establishing the company as a major player in the entertainment industry.

As the streaming service took off, Hollywood studios and other video distributors such as Starz have been demanding higher fees for the licensing rights to their content - a trend that caused Netflix to dig deeper into its subscribers' wallets.

Even with fewer subscribers, Netflix expects to bring in $10 million to $25 million more from its customers than during the July-September period than it did April-June.

Netflix revenue won't keep rising, though, if more subscribers flee. Pachter thinks that could still happen because some customers won't be billed at the higher rates until the end of the month.

Besides being more expensive, Netflix's new pricing structure is also more complicated for subscribers who want to stream and rent DVDs from the service.

Until Sept. 1, Netflix offered plans that bundled DVD rentals and unlimited video streaming for as little as $10 per month. Those options are now sold separately, resulting in a cost of at least $16 per month for people who want streaming and DVDs. Having both choices is appealing because Netflix's streaming library primarily consists of old TV shows and movies, leaving DVDs as the main way to see recently released films.

To hold down costs in a tough economy, millions of Netflix customers are either limiting their subscriptions to a streaming-only or DVD-only plan. Other customers are canceling their accounts to protest the new pricing scheme. Those canceling are following through on threats that were made on Facebook and Netflix's own blog after the higher prices were announced.

Despite the vitriolic reaction, Netflix CEO Reed Hastings still thought the company would be able to add subscribers. In late July, he issued a forecast that indicated Netflix would end September with 25 million U.S. subscribers, up from 24.6 million in June. That prediction was lowered Thursday to 24 million. The revision mostly reflects Netflix's expectation that it will have 800,000 fewer DVD-only subscribers than it previously thought.

Many of the people no longer renting DVDs from Netflix will get their discs elsewhere. That could be a boon for Redbox, which rents DVDs for $1 per night through 33,330 kiosks in supermarkets and other retailers, and Blockbuster, which still has 1,500 U.S. stores after emerging from bankruptcy protection under the ownership of Dish Network Corp. Investors are betting Redbox will be the main beneficiary; the shares of Redbox owner Coinstar surged $3.33, or more than 7 percent, to close at $48.55 on Thursday. Dish Network's shares edged up 11 cents to $25.82.

This could be an opportune time for would-be rivals to attack Netflix's streaming service too, BTIG Research analyst Richard Greenfield wrote in a Thursday blog post. Internet retailer Amazon.com Inc. launched a free streaming service for subscribers to its two-day shipping service earlier this year. Greenfield and other analysts believe Google Inc., already the owner of YouTube, is eager to expand its Internet video offerings to include more movies. One way Google could achieve that would be to buy Hulu.com, which has been put up by for sale by the television network owners that supply its video content.

"Netflix made a bad move, raising prices as much as they did," Pachter said.