

Netflix stock falls as talks on Starz deal unravel

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In this Aug. 2, 2011 photo shows Netflix CEO Reed Hastings speaking at a meeting in Palo Alto, Calif. Starz says that it has ended renewal talks with Netflix on providing movies and other content for its on-demand streaming service. The decision announced Thursday deals a big blow to Netflix Inc.'s streaming service at a time when many users are angry about its recent decision to raise its monthly subscription prices. (AP Photo/Paul Sakuma)

(AP) -- Netflix's negotiations to keep a key piece of its Internet video library have collapsed, dealing a major blow to the largest U.S. video subscription service as it raises the prices for most of its 25 million customers. The setback triggered a nearly 9 percent drop in Netflix Inc.'s

stock price.

Starz Entertainment delivered the bad news Thursday in a terse statement announcing that it won't renew a contract that allows Netflix to show a lineup of recently released movies and TV shows over high-speed Internet connections.

That means Starz content will be removed from Netflix's [streaming service](#) starting in March. Starz' library includes movies from [Walt Disney Co.](#)'s assorted studios and, until recently, [Sony Corp.](#)

The talks fell apart after the two sides disagreed over the value of the Starz content and how it should be sold to Netflix subscribers, according to people familiar with the negotiations. The people asked not to be identified because they weren't authorized to speak publicly.

The content from Starz' cable TV channel played an instrumental role in increasing usage of Netflix's Internet service and helped Netflix add nearly 17 million subscribers since the deal was signed in October 2008.

That growth probably wouldn't have happened without the boost that the Starz deal gave to Netflix streaming, said Janney Montgomery Scott analyst Tony Wible.

"What created (Netflix's success in streaming) is frankly, initially getting Starz, getting that content, which got you more subscribers, which allowed you to buy more content," Wible said. "The virtuous cycle that has made Netflix what it is could work against it. If you lose content, you lose subscribers; ... it could be a downward spiral from here."

Netflix had been expected to work out a new contract with Starz, although at a much higher price than the estimated \$30 million a year that it had been paying under the current agreement. Netflix CEO Reed

Hastings acknowledged earlier this year that the company might have to pay as much as \$250 million a year to retain the Starz rights when the current contract expires in February.

But those hopes were dashed, if not blown up completely, with Thursday's bombshell dropped by Starz CEO Chris Albrecht.

The timing of the announcement was seen a way to kick Netflix in the shins at a particularly vulnerable time. It came on the first day of a new Netflix pricing system that will hit U.S. subscribers with price increase of as much as 60 percent if they want to continue to get DVD rentals through the mail along with unlimited streaming of Internet video. The new pricing system has incensed a large group of Netflix subscribers who have threatened to cancel their accounts, a backlash that could intensify if it looks like Netflix's streaming library is becoming less attractive.

Albrecht said Starz had decided against a renewal "to protect the premium nature of our brand by preserving the appropriate pricing and packaging of our exclusive and highly valuable content."

The contract renewal talks broke down when Netflix refused to meet demands that could have driven up the annual licensing rights to \$300 million or more, according to one person familiar with the negotiations.

A major sticking point arose when Starz insisted its content be corralled on a higher-price tier, another person said. Instead of making their content available to any Netflix subscriber paying just \$8 per month, Starz executives wanted viewership limited to people paying at least \$16 per month for a package that bundles DVD rentals with Internet video.

That stipulation was seen as a way to preserve Starz' relationship with cable and satellite TV distributors, who include Starz in channel

packages that cost far more than the \$8 monthly fee for Netflix streaming. Albrecht said Starz, part of Liberty Media Corp., is in an "excellent position" to make more money from other sources besides Netflix.

Netflix tried to downplay the possible loss of the Starz relationship. The company, which is based in Los Gatos, Calif., said it would spend the \$250 million that Hastings had earmarked for the Starz renewal to buy audience-pleasing content from other distributors. Hastings has left no doubt that he intends to invest heavily in Netflix's Internet video library because he wants more subscribers to use that option. That would allow Netflix to cut postage and other costs to mail DVD rentals to its customers.

As it is, Starz has become less important to Netflix as the service expanded its streaming rights. In June, Sony also stopped allowing its movies, which include "Easy A" and "Grown Ups," to part of Starz streaming in June. Those factors have reduced Starz's share of Netflix streaming viewership in the U.S. to 8 percent, according to Netflix.

The rising cost for Internet streaming rights is one of the reasons that Netflix raised its prices for people who want to rent DVDs through the mail and stream video. The changes don't affect customers who subscribe to the streaming-only plan.

Starz's decision to end the talks with Netflix underscores the escalating tensions with pay-TV services that view Netflix's popularity as a competitive threat. Time Warner Inc.'s HBO has consistently refused to license its shows for Netflix streaming, and Showtime recently has declined to make some of its top series, including "Dexter" and "Californication" available to the service.

Morningstar analyst Michael Corty said he thinks Netflix can salvage the

Starz deal, given there is still six months before the current contract expires. To do that, Netflix will likely have to pay even more than it intended because Starz appears to have more negotiating leverage, Corty said.

Although Albrecht's statement made it sound as if there is little chance of a new deal, Netflix left the door open.

"We have tremendous respect for the Starz creative team, and we look forward to someday licensing some of their original or licensed content," Netflix said in a statement.

The falling out with Starz added to the worries of Netflix investors already fretting about the higher prices driving away subscribers. Netflix's stock plunged \$19.97 to \$213.30 in extended trading Thursday, after the announcement by Starz.

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