Netflix customer growth eclipses 3Q earnings miss

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In this file photo made July 20, 2010, a Netflix customer holds up a movie in Palo Alto, Calif. Netflix Inc. reports quarterly financial earnings Wednesday, Oct. 20, 2010, after the market close. (AP Photo/Paul Sakuma, file)

(AP) -- Netflix Inc.'s video subscription service won another horde of new fans in the third quarter, overshadowing a rare earnings shortfall.

The addition of 1.9 million subscribers seemed to matter far more to investors than an earnings figure that was a penny below analyst estimates. Netflix shares surged by more than 9 percent after the numbers came out.

Netflix earned $38 million, or 70 cents per share. That's up 26 percent from $30.1 million, or 52 cents per share, at the same time last year.

Analysts, on average, had projected third-quarter earnings of 70 cents per share, based on a Thomson Reuters poll.

Revenue rose 31 percent from last year to $553 million, $2 million above analyst forecasts.

The company, based in Los Gatos, needs to show the popularity of its service won't be a short-lived phenomenon to support a stock that has nearly tripled in price so far this year. The shares ended Wednesday's regular session at $153.15 before adding $14.05 in extended trading.

The third quarter, which spans Netflix's traditionally sluggish season, went a long way toward proving the company's staying power.

The 16.9 million subscribers that Netflix boasted at the end of September was 200,000 above the best-case scenario projected by the company three months ago.

Management expects to gain another 2.1 million to 2.9 million customers by year's end. That means Netflix could enter 2011 with more than 19 million subscribers, doubling the service's size in two years.

The explosive growth has coincided with Netflix's efforts to expand an Internet video streaming library that initially was designed to supplement the DVD-by-mail service that it launched in 1999.

With high-speed online access now becoming a household staple and an array of gadgets making it easier to connect high-definition TVs to the Web, Netflix is about to reach a tipping point in its evolution as Internet streaming goes mainstream.

At some point in the fourth quarter, Netflix CEO Reed Hastings predicted the company's subscribers collectively will watch more hours of video streamed on the Web than on DVD players. That transition is expected to lower the amount of money Netflix spends for the postage to deliver DVDs, something that should eventually help boost Netflix's earnings.

For now, though, Netflix is spending heavily to obtain the streaming rights to more movies and TV shows to help lure more customers and shift more of its existing subscribers away from DVDs.

In the third quarter, Netflix spent $115 million on video streaming rights, up from just $10 million at the same time last year. Meanwhile, spending on DVDs dropped 35 percent from a year ago to just under $30 million in the third quarter.

Netflix's streaming service has become so popular that it is now the largest source of online traffic in the U.S. during peak evening hours, according to a report released Wednesday by Sandvine Inc., a Canadian company that supplies traffic-management equipment to Internet service providers.

Netflix accounts for 20.6 percent of peak traffic to Internet users, more than double that of Google Inc.'s YouTube, Sandvine said.

The streaming service may start hogging Internet bandwidth in Canada too. Netflix introduced a streaming-only plan priced at $8 per month in Canada late in the third quarter. In the U.S., Netflix's plans for DVDs and unlimited streaming start at $9 per month. The company is experimenting with offering an streaming-only option in the U.S., too.