

Netflix adds its name to dot-com survivor list

By Scott Herhold

27 January 2003

San Jose Mercury News

In the short, painful history of the boom and crash, only a handful of dot-com companies has made it to profitability and credibility: eBay, Expedia, Yahoo and perhaps Amazon.

Now you might want to add one more to your potential watch list: Los Gatos-based Netflix (NFLX), which has seized on the seemingly offbeat idea of renting DVDs through the mail.

I've written skeptically about Netflix before. At \$12.33 a share as of Friday, it's still well below its \$15 IPO price in May. It's not an investment for the faint of heart.

But a couple of recent positive signs make it worth watching the stock, which has moved up smartly since reaching a low of \$5.22 in October.

(Full disclosure: I'm a Netflix subscriber and I like the service. The biggest problem in my family is the jockeying over which movies to watch).

First, the company recently put out an encouraging earnings report for its latest quarter. For the quarter ended Dec. 31, it reported a loss of 10 cents a share, a huge improvement from the \$2.65-a-share loss in the same period a year ago. The consensus among analysts is that the company will achieve profitability this year. The quarterly revenue of \$45.2 million was up 109 percent from the year before.

Second, competition from Blockbuster and Wal-Mart has been slow off the mark, even though both are potentially formidable opponents.

Wal-Mart, which has a slightly cheaper service than Netflix (\$18.86 vs. \$19.95 a month), has been shipping its DVDs from Georgia, which means that subscribers can wait three days or longer to get what they've ordered.

Netflix, on the other hand, has already established 11 regional distribution centers. In much of the Bay Area, it can deliver movies on a next-day basis. In San Francisco, it claims to have 5 percent of households as subscribers.

``You have to give the management of this team credit for putting together such a smooth operation," says Bill Elkus, the managing director of Clearstone Venture Partners. ``The big question is whether their loyal customer base and their intense focus on one product will overwhelm the cost advantage that Blockbuster or others like them would have in reaching the consumer."

The rivals aren't sleeping: The new president of Wal-Mart's online division, John Fleming, says he plans a bigger rollout of the service soon.

But so far Netflix -- with its red envelopes and no late fees -- has established a niche.

``It's not that they (the rivals) couldn't compete vigorously," says Netflix Chief Executive Reed Hastings. ``But it would probably take an investment of a couple hundred million dollars to get a leadership position. That's a big investment."

A few caveats: Short-sellers, who bet on a stock's decline, still have a heavy interest in Netflix: Some 3.3 million shares are sold short, a quarter of the float. Though that number has been declining, it reflects significant doubt.

Second, with the recent ending of the lockup period -- and the year-end earnings out of the way -- you'll undoubtedly see more insider selling. Last week, Netflix's vice president of marketing, Leslie Kilgore, exercised options and sold 70,000 shares at \$12.03 a share. Given that Netflix's average daily trading volume is only about 350,000 shares, a transaction like that can have outsized impact.

All these are reasons for caution. But unlike a lot of businesses that were founded during the boom, Netflix is worth watching. It's an action flick, not a slumbering matinee feature.