

Is Netflix killing Redbox? Not so fast.

By [Paul R. La Monica](#), assistant managing editor January 14, 2011: 12:11 PM ET

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NEW YORK (CNMoney) -- Has the red envelope finally triumphed over the Redbox?

Coinstar ([CSTR](#)), the parent company of the \$1 DVD rental kiosk service, [plunged 25% Friday morning](#) after reporting that its fourth quarter sales and profits were far below forecasts.



But shares of its top rival, Netflix ([NFLX](#)), dipped a bit as well.

That's telling. It's probably a mistake to view Coinstar's results as a sign that Netflix is hammering nails in Redbox's coffin.

It doesn't appear that consumers were suddenly less interested in watching DVDs during the holidays. In fact, Coinstar CEO Paul Davis said in a statement Thursday that visits to Redbox kiosks in the fourth quarter "remained strong." It's just that consumers rented fewer movies -- meaning they stopped by but didn't spot as many titles they wanted to take home.

Revenue from Redbox rose 38% in the fourth quarter, and same-store sales (an important metric for retailers) were up 12.5%, Coinstar said. That's impressive growth. It just fell short of analysts' even higher expectations.

Consumers haven't suddenly come to the conclusion *en masse* that streaming movies to their TV or computer via Netflix makes more sense than schlepping out to a grocery store or drugstore to pick up a DVD.

"Most people are wondering if Coinstar's results mean that DVDs are dead and everyone is shifting to streaming," said Eric Wold, an analyst with Merriman Capital. "If that were the case, people wouldn't be going to kiosks at all."

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Coinstar simply fell victim to lofty forecasts, just as many momentum stocks do.

"A lot of the disappointment with Redbox had to do with expectations being so high as opposed to the actual results being bad. When you look at DVD rentals, the growth is still there," said Mark Harding, an analyst with Maxim Group.

Also worth nothing: This was the first holiday period in which Redbox had to deal with the fact that it no longer has many new releases in its kiosks on the day that the DVDs go on sale.

Redbox bowed to pressure from the big studios earlier this year and agreed to only offer prominent new movies 28 days after their on-sale date. That took away one competitive advantage Redbox had over Netflix, which also has a four-week delay for new movies.

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Michael Pachter, an analyst with Wedbush Securities, said it is stunning that Coinstar didn't factor in the possibility of lower sales in the fourth quarter because of the delay.

A big chunk of DVDs go on sale just in time for the holidays, and the studios do their best to market the heck out of them, Pachter noted. So it's a bigger problem in the fourth quarter (than, say, in the middle of July) if a consumer goes to a Redbox kiosk and can't immediately get a widely touted new release.

"Coinstar's biggest problem is they suck at guidance, not that their business is bad," he said. "They are a good company, but they are subject to growing pains."

[Netflix added to S&P 500 as index gets 21st century makeover](#)

So what does all this mean for Netflix?

Wold said he still likes the stock because he believes Netflix is becoming a *de facto* standard for video streaming. The company is being savvy in striking partnerships with gadget makers, he said.

For example, Netflix announced at last week's CES that Sharp, Sony, and Toshiba will soon include a Netflix one-click button on remote controls for their Internet-connected TVs.

Harding expects Netflix to report strong results for the fourth quarter. Analysts forecast earnings per share growth of 27% on the back of a sales increase of 34%.

But will that be enough to satisfy investors?

Netflix's stock has pulled back a bit since hitting an all-time high of nearly \$210 a share in early December. The departure of the company's chief financial officer later that month spooked some investors.

But even with the stock down about 10% from its peak, shares still trade at an extremely rich valuation of almost 50 times 2011 earnings estimates.

With a multiple like that, Netflix may not be just priced to perfection. It's priced as if streaming videos will be able to cure cancer, bring peace to the Middle East and turn the LeBron James-less Cleveland Cavaliers into a championship caliber basketball team. Good luck.

"I love Netflix. Management is brilliant and the service is great. But the stock is not worth what it's trading at," Pachter said. "Investors believe everybody is migrating to streaming tomorrow. But the Hollywood studios are not going to get rid of DVDs."

Reader comment of the week: I wrote on Thursday about how [stocks continue to head higher](#) despite many significant long-term challenges facing the United States. Unsurprisingly, the deficit hawks took flight.

"All the FED is doing is buying time ... until the newest Titanic, the USA, collapses in on itself. The problem isn't the corporations it's the country. We can't continue spending at this pace," wrote a reader whose Facebook name is Ebenezer Lucky.

"The USA will be forced to raise taxes in order to get additional revenue at which point these corporations will simply move to a more favorable nation. It can and will happen."

A bit alarmist? Of course. But it's true that Congress (and the market) can't keep kicking the debt can down the road indefinitely.

-- The opinions expressed in this commentary are solely those of Paul R. La Monica. Other than Time Warner, the parent of CNNMoney, and Abbott Laboratories, La Monica does not own positions in any individual stocks.