

Netflix Blaming New Chip Cards for Slowdown Seen as 'Bogeyman'

Olga Kharif Lucas Shaw Elizabeth Dexheimer

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Netflix Blames Chipped Credit Cards for Slow Growth

- ▶ Some U.S. users got cut off after getting new cards: Netflix
- ▶ Company is using the card change as 'whipping boy:' analyst

Retailers routinely blame the weather for sub-par results. Netflix Inc. came up with a novel excuse: a nationwide transition to chip-based credit cards.

The online video service said some U.S. subscribers got cut off after their old cards stored on its system stopped working, which contributed to disappointing user growth last quarter. Payment analysts were surprised that a company like Netflix was caught off-guard by the arrival of chip cards, which, they say, should have had little impact on the business. Most card numbers haven't changed as a result of the switch, and even when they did, Netflix should have been prepared to update the information.

"It seems like they are grasping for a bogeyman here," said David Robertson, president of card researcher the Nilson Report.

Banks try not to change account numbers unless a card was stolen, so their customers won't have to update their account details with subscription services like Netflix, Robertson said. JPMorgan Chase & Co. and Bank of

America Corp., which are among the largest card issuers in the U.S., said that their customer account numbers haven't changed as they issued new chip cards.

The move to the safer chip-loaded cards in the U.S. has long been known, so businesses that are getting a big chunk of their revenue from automatic monthly payments have had plenty of time to get ready for it.

Some banks changed the account numbers, Netflix executives said on the company's earnings call Wednesday, which was one of several reasons why subscriber growth slowed last quarter.

"It's an issue of scale," the company said Thursday by e-mail. "When you're processing recurring payments for some 42 million people, the influx of new credit cards, many of which had new expiration dates or security codes, can have a discernible impact even though it's quite small relative to the size of our U.S. membership."

Netflix failed to anticipate a surge in what the company calls involuntary churn, Chief Executive Officer Reed Hastings said in an interview. The company didn't adjust its forecasts, and thus missed its targets.

"It's a minor tactical issue," Hastings said.

'Whipping Boy'

Retailers usually have a system in place to keep their customers' information up to date and avoid what Hastings called an "inability to collect" from subscribers who got new cards. Many use so-called updater services, which notify them of changes in customers' cards. And they have a standard method -- often e-mail -- to contact the customers and make the changes. Businesses have always had to periodically handle updates in card information, such as expiration dates and security numbers on the back. The chip cards haven't added any new complications.

Most U.S. retailers and banks were supposed to switch from magnetic stripes to the more secure chip-based cards on Oct. 1 -- finally catching up with a system that Europe has been using since the 1990s. But as of the deadline, half of Americans didn't have a chip card. The underlying technology called EMV -- for Europay MasterCard Visa -- makes it harder for criminals to clone cards for use in retail stores.

"Netflix is using EMV as a whipping boy for their customer attrition," said Julie Conroy, a payments analyst who specializes in fraud at Aite Group. "I don't think a significant customer churn could be blamed on the chip migration."

Subscriber growth is one of the primary numbers investors use to value Netflix, especially because Hastings has operated the company at break even while pursuing global expansion. Third-quarter results, released Wednesday after the markets closed, sent the shares down 8.3 percent Thursday. They were little changed Friday at \$101.27

as of 9:39 a.m. in New York.

The online video service said Wednesday that it gained 880,000 domestic subscribers in the third quarter, 370,000 fewer than analysts predicted.

Wall Street analysts were divided on the results. Ken Sena of Evercore ISI said the results were consistent with concerns about Netflix's valuation as it faces increased video competition. FBR's Barton Crockett said blaming the shortfall on credit cards was credible, while Pacific Crest's Andy Hargreaves pointed to the strong demand from international markets.

Even with the glitch, Netflix projects it will still have added close to 6 million subscribers in the U.S. by year-end.

"We'll be through it in a couple months," CEO Hastings said. "Next year everyone will have chip-based cards."

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