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EDITED TRANSCRIPT

NFLX - Q2 2012 Netflix, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Netflix second quarter 2012 earnings Q&A session. At this time, all participants are in a listen-only mode. Later will conduct a question-and-answer session and instructions will follow at that time. Today's call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to Ellie Mertz, Vice President of Finance and Investor Relations. Please go ahead.

Ellie Mertz - Netflix Inc - VP of IR

Thank you, and good afternoon. Welcome to the Netflix second quarter 2012 earnings Q&A session. I am joined here by Reed Hastings, CEO and David Wells, CFO. We announced our financial results for the second quarter at approximately 1 PM Pacific time today. The shareholder letter and the Q2 financial results and the webcast of this Q&A session are all available at the Company's Investor Relations website at ir.netflix.com.

As is our standard practice, we will begin the call with questions received via e-mail. Please e-mail your questions to ir@netflix.com. After e-mail Q&A, we will also open up the phone lines in case there are additional questions not covered by the e-mail Q&A or letter. The dial-in number is within our investor letter, but let me repeat it now. Please call (760)666-3613 if you'd like to get in the queue. We may make forward-looking statements during this call regarding the Company's future performance. Actual results may differ materially from these statements due to the risks and uncertainties related to the business. A detailed discussion of such risks and uncertainties is contained in our filings with the Securities and Exchange Commission, including our annual report on Form 10K filed with the commission on February 10, 2012. A rebroadcast of this Q&A session will be available at the Netflix website after 6 PM Pacific today.



QUESTIONS AND ANSWERS

Ellie Mertz - *Netflix Inc - VP of IR*

Now, let's move directly to questions. As is our standard practice, we've organized the questions by topic as we have received them via e-mail this afternoon. So, we're going to start with questions about subscriber metrics and our guidance. First question -- how closely tied are hours viewed per subscriber and your subscriber metric, especially churn? Has there been any material improvement in customer churn in domestic streaming? If not, why does not the higher engagement reflected in the higher hours translate into improved churn?

Reed Hastings - *Netflix Inc - CEO*

Well, absolutely, viewing and retention are connected. The more a subscriber uses Netflix, the more that they stay a subscriber as you would expect. And there is significant variation between those that who watch an hour a month, 10 hours a month and 50 hours a month, and so we're always trying to improve the experience, more content, better viewing, better streaming to increase the amount of viewing because then subscribers prioritize the \$7.99 for Netflix above other expenses.

Ellie Mertz - *Netflix Inc - VP of IR*

You said in the letter the Netflix's goal was to become the world's most popular TV and movie service. Presumably, you're defining success by the number of global streaming subscribers. The bears believe that Netflix cannot become this large because at \$8 a month, the Company cannot compensate the content providers enough. Can you comment on this?

Reed Hastings - *Netflix Inc - CEO*

Well, we've been charging \$8 a month for streaming for several years, and we've continued to grow the subscriber growth and to grow the content. And we're basically continuing to execute on that game plan, and that's helped us grow very considerably. So, I don't see what the issue is per se with an \$8 service if you get a lot of members, and that's what we're focused on, to be able to continue to build out the content.

Ellie Mertz - *Netflix Inc - VP of IR*

On finance, I'm curious about the Olympic impact comment. In previous Olympics, how much did the games impact subscriber growth?

David Wells - *Netflix Inc - CFO*

Well, it's hard for us to gauge the Beijing 2008 Olympics because we had a three-day DVD outage right at the same time. I would say that we did feel some impact and there's uncertainty around whether that impact is permanent meaning it's just a permanent reduction in acquisitions or if it's just a deferral through the games. So, I would say that through the first three weeks of 2012, we would've expected to be above 2010 levels. And what we're seeing is that we are nearly at 2010 levels, so it gave us some more uncertainty in terms of what Q3 would look like in terms of being at a 2010 level of 1.8 million net additions.

Ellie Mertz - *Netflix Inc - VP of IR*

A related question, you talked about some of the headwinds you're facing on subscribes, including the Olympics this summer. Given these headwinds, what will it take to reach your full-year goal for net adds? Another question, what are the risks in your Q4 net add guidance to make that 7 million number?



Reed Hastings - *Netflix Inc - CEO*

Well, I think there's a number of puts and calls. There's Netflix's reputation as it continues to build back, there's improvements that we make between now and Q4. Then there's all the smart TV sales that all the manufacturers are very focused on Q4. So, those would be all the positives. Negatives would be if there's substantial new competition between now and then, other factors like that. Economic issues don't tend to affect us much because we are so -- such a good value, so I don't think we have much risk on up and downs in the economy.

Ellie Mertz - *Netflix Inc - VP of IR*

Question on devices. Does the slowdown in game console and DVD players sales impact new streaming adoption? What about the slate of low-end tablets in the back half? How are you thinking about the benefits from smaller and cheaper tablets?

Reed Hastings - *Netflix Inc - CEO*

Well, let's see, take the second part first. On tablets, they're mostly used at this point as a laptop substitute, and so we don't see it as net incremental availability because everyone who's got a tablet also has a laptop and could've been using us on a laptop. And then the Blu-ray -- the question asked about DVD slowdown, that's true, but Blu-rays haven't yet slowed down. Presumably they will eventually, and most Blu-ray players can play Netflix. And then the big category growth is in smart TVs.

Ellie Mertz - *Netflix Inc - VP of IR*

Can you give us some color on US streaming growth adds and churn during the quarter? Were both metrics as you expected? Was there a seasonal pickup in churn?

Reed Hastings - *Netflix Inc - CEO*

We hit basically right above the midpoint of the range, so yes, both churn and gross additions were as expected. We saw a seasonal -- a small seasonal decline in retention, which we had seen before from Q1 to Q2. So, we are right where we thought we were going to be.

Ellie Mertz - *Netflix Inc - VP of IR*

Moving to questions about content, has there been a shift in content acquisition away from large-scale buys to a more focused cost effective approach that targets lucrative niche areas such as kids TV, past seasons of original series such as Mad Men, not to mention your original programming? It appears that a more streamlined focused strategy can help rein in content costs while quite possibly improving the streaming selection. In other words, is this just a focus on quality over quantity?

Reed Hastings - *Netflix Inc - CEO*

Well, one, we're not trying to rein in content costs. We're continuing to invest more and more each year in content. Two, there's no shift. We're always focused on what is the piece of content cost versus how much we think it's going to get viewed. And so where you see us get small or interesting films or TV shows, it's because we think the economics work in the amount we pay versus how much we think it's going to get viewed. And that's been consistent for several years.



Ellie Mertz - *Netflix Inc - VP of IR*

What are your release plans for original programming? While consumers would clearly love you to follow the all at once strategy to enable binge viewing, that strategy appears far from ideal vis-a-vis churn as disconnecting and connecting Netflix is so easy. How do you balance those two dynamics?

Reed Hastings - *Netflix Inc - CEO*

Well, we're fundamentally focused on making it a great consumer experience, and we do think it's an improved experience that only an on-demand service like Netflix can offer to have all the episodes at once, and so we're going down that path. And I don't think there's a negative churn implication to it. I think there's a positive implication because it's a better and unique experience. And the more we develop compelling experiences, the bigger our market opportunity is.

David Wells - *Netflix Inc - CFO*

I would also add to that that's our expectation is if we're successful with our originals, that we'll have multiple launches. The availability of one season of one particular title might be followed up by another title that becomes available.

Reed Hastings - *Netflix Inc - CEO*

And as an example of that, Lilyhammer Season Two, which I know all of you are hanging on is going to be available next year.

Ellie Mertz - *Netflix Inc - VP of IR*

Another question on originals, you indicated you would, quote, blow away already impressive streaming hours when originals launch in 2013. What gives you the confidence that it will not simply be substitute for existing Netflix content?

Reed Hastings - *Netflix Inc - CEO*

I think what we've seen is growth in viewing. It's just huge over the last five years, and we expect that growth in streaming to continue, including the originals. And we've been very happy relative to the investment on Lilyhammer. And so we're feeling quite good about the rise of Arrested Development Season Four, House of Cards and our other originals.

Ellie Mertz - *Netflix Inc - VP of IR*

Final question on originals. Why have originals slipped to 2013 from late 2012? Is production on schedule?

Reed Hastings - *Netflix Inc - CEO*

Production's on schedule for first quarter 2013, yes.

Ellie Mertz - *Netflix Inc - VP of IR*

Streaming consumption seems to have swung heavily towards TV shows, and Netflix is benefiting from having some high-profile exclusive TV content like Mad Men. Is this a core strategy or at the right price, would you shift your content dollars more aggressively back towards movies?



Reed Hastings - *Netflix Inc - CEO*

We are in the business of providing great entertainment to our members at a very low price. And part of that is the programming strategy, which is to acquire content that, relative to the dollars we pay for it, gets viewed a lot. And we are agnostic as to whether that's features TV, kids TV, different kinds of episodic. And so where you see dollars shifting around, it's because that's where there is value to offer our subscribers. So yes, we would be totally open to getting good value either on the feature side, on the many different types of television side, including originals.

Ellie Mertz - *Netflix Inc - VP of IR*

It sounds like you will have nonexclusive EPIX content for one more year. Are current discussions on potential exclusivity complete? Any chance of keeping the content beyond 1 year?

Reed Hastings - *Netflix Inc - CEO*

Well, EPIX is great content and we have it for the next year guaranteed and then we'll go from there. Certainly, it's working very well for both EPIX and us at this point.

Ellie Mertz - *Netflix Inc - VP of IR*

Another question on that, how would you expect Netflix to be impacted by the likely appearance of EPIX movies on competing services?

Reed Hastings - *Netflix Inc - CEO*

We wouldn't expect to be affected significantly. EPIX is not a particularly large source of total viewing. Much more of our viewing is on our exclusives, as was referenced, Mad Men, Breaking Bad and such shows.

Ellie Mertz - *Netflix Inc - VP of IR*

Do think the recent renegotiations between MSOs and cable companies will negatively impact your access to content or the price you'll be asked to pay going forward?

Reed Hastings - *Netflix Inc - CEO*

No. We don't have that expectation.

Ellie Mertz - *Netflix Inc - VP of IR*

Question on HBO. In the letter you commented on working together with HBO. How would you work together with HBO? Would you license HBO programming and/or co-finance programming? Potential timing?

Reed Hastings - *Netflix Inc - CEO*

I'm not sure what we would do. My point is that we're just another network and that when you have multiple networks, they often find ways of working together. So, it's a general point that it's not a zero-sum game between HBO and Netflix. And that in fact, there may be ways of working together, but there's nothing particularly pressing.



Ellie Mertz - *Netflix Inc - VP of IR*

Moving to a question on competition. How does Netflix plan on competing with growing online streamers? For example, with Amazon, Hulu and Google?

Reed Hastings - *Netflix Inc - CEO*

Well, we've been competing with two of those. Google doesn't really have subscription premium TV service at this point, and so with Google, we advertise a lot on YouTube. And we are one of the biggest advertisers there, which is very successful for us and for Google. In terms of Amazon and Hulu Plus, if you look at the Sandvine data on streaming usage in the US, we've got a huge lead, and that lead is only growing.

Ellie Mertz - *Netflix Inc - VP of IR*

Moving to questions on international. What gives you the confidence that you can achieve breakeven, let alone profitability, in international markets outside of Canada, arguably the 51st state

David Wells - *Netflix Inc - CFO*

We've seen increasing engagement in those markets outside of the US. And we've seen our ability to improve our losses from Q1 to Q2. Now, we've made the decision to raise our content spend in the UK like we did in Canada because we are encouraged by the results, the early results we've seen. I think it's the ability for us to demonstrate the growth in those markets quickly and in the engagement in those markets that gives us the confidence that we can --

Reed Hastings - *Netflix Inc - CEO*

So we can get to profit both break even and not just to break even, and to substantial probability.

David Wells - *Netflix Inc - CFO*

Correct.

Ellie Mertz - *Netflix Inc - VP of IR*

Some of these are related questions. What would cause the Company to slow its international plans down and concentrating on growing consolidated profits instead?

Reed Hastings - *Netflix Inc - CEO*

When we have finished our international expansion, we would certainly do that. But until then, our model as we've explained is to get back to profitability and then open a new market, get back to probability, open a new market. And that's based on the view that there is an extraordinary once in a lifetime, once in a generation opportunity to build a franchise in many markets as we've been building. And we think that our UK, Ireland and Lat Am expansions to date will, over time, prove to be very valuable and we'll all be very happy that we've done it.



Ellie Mertz - *Netflix Inc - VP of IR*

So, doesn't this mean that the Street should not assume meaningful growth in reported net income for the next few years? The process from new market launches offsetting rising profits in the rest of the business?

Reed Hastings - *Netflix Inc - CEO*

Yes, that's completely consistent with what we've been saying. As long as there are good markets to enter around the world, that we would take the US profits or the global profits and put them into faster international expansion.

David Wells - *Netflix Inc - CFO*

And I'd say just to round that out, the three conditions for additional expansion that we've said before were one, that we would get back to global profitability to a breakeven level, two, that we are pleased with the progress that we're making in our existing markets. And three, that there would be an additional market identified that we think represents a good opportunity to expand.

Ellie Mertz - *Netflix Inc - VP of IR*

Given the capital needs for launching new markets, particularly for content acquisition, is income statement based profitability the right metric to use in determining new market launches, or is there a component of cash flow or cash balance that you should also use to determine the timing and size of new market launches?

Reed Hastings - *Netflix Inc - CEO*

If international was a user of cash outside the P&L, that could be true. But it's not. It's substantially neutral between cash and P&L on international. The only big cash uses relative to P&L are the originals and some of the movie output deals. Anything else, David, on --

David Wells - *Netflix Inc - CFO*

No. I'd say that there is a small -- a minor thing in Q2 where we had content added in the UK to the site that came in mid-quarter that was small use of cash. But other than the mid-quarter, that's correct. We are -- our cash -- our content expense is matching our content cash, other than those exceptions you mentioned.

Ellie Mertz - *Netflix Inc - VP of IR*

Do you have enough data to discuss whether or not the usage trends in the international markets differ compared to the US, be it TV shows versus movies, amount of time spent watching, et cetera?

Reed Hastings - *Netflix Inc - CEO*

There are many interesting similarities and differences. For competitive reasons, I'm not going to go into them.

Ellie Mertz - *Netflix Inc - VP of IR*

In your letter, under the Latin American section, you state that you have modified your sign-up flow to improve free trial-to-paid conversions. Can you flesh that out for us and tell us exactly what you mean by that? What you mean by modifying your sign up flow?

Reed Hastings - *Netflix Inc - CEO*

Why don't you answer that, Ellie?

Ellie Mertz - *Netflix Inc - VP of IR*

One of the challenges we have in Latin America is that there's great popularity for trying a free trial, yet a month goes by and we try to run your credit card, your payment method and we can't get the payment method to run. So, what we've done in Latin America is increase our upfront checks to make sure that when that free trial comes to completion, we have a valid payment method on file. And so what we've done is increase the validation and seeing the results through improved conversion.

Turning to some questions on marketing, given the solid earnings results, I would like to know if you believe you might have been able to dial up a few more subscriber adds with a somewhat larger marketing budget? In other words, why did you decrease marketing expense quarter over quarter with net adds slowing?

David Wells - *Netflix Inc - CFO*

So narrowly, yes, we could have, but that would have been inefficient spend. Typically, marketing goes down from Q1 to Q2 because it's less -- it's a less attractive quarter to acquire new subscribers. I don't know if you would add --

Ellie Mertz - *Netflix Inc - VP of IR*

Why do you emphasize content titles so much in the investor letter but not in your marketing?

Reed Hastings - *Netflix Inc - CEO*

In our marketing, we're really focused on trying Netflix for free, and then a consumer gets to experience the content. And so that -- it's a little different with investors. They already know of the content, they're generally users. And what content in the letter helps do is flesh out the picture of the new things that they might not otherwise be aware of. So, there's sort of two different audiences.

Ellie Mertz - *Netflix Inc - VP of IR*

Some questions on your DVD business. Redbox Instant by Verizon unveiled its management team this morning. Does becoming Redbox Instant subscription offering increase the importance of your Netflix DVD business?

Reed Hastings - *Netflix Inc - CEO*

Our Netflix DVD business is very important, both amongst its 9-plus million members, and for the profits it generates. We don't see any change in that. The Redbox Verizon streaming subscription service will have a long way to go just to break through the top three. So, we'll see what happens as they launch.

Ellie Mertz - *Netflix Inc - VP of IR*

We've heard and read increasing complaints about extended wait times for Netflix DVDs. We are curious how DVD inventory per subscriber compares to your historic metrics and whether you are using DVD inventory as a margin lever?



David Wells - *Netflix Inc - CFO*

We measure something called first choice here and have for a long time, and I would say that metric was flat through the second quarter. There are certain titles that get caught in between content negotiation deals. And I would say HBO -- for the HBO titles we are one of the only places you can actually get HBO through physical delivery, so we may be seeing some concentration of demand on those titles. In general it's not a large profit lever for us because most of our shipments are catalog. And I would say that the profit characteristics of that from Q1 to Q2 were more driven by reduced usage that's seasonal -- seasonally low in Q2.

Ellie Mertz - *Netflix Inc - VP of IR*

How sustainable are the contribution margins for the DVD business going forward, especially beyond this year?

David Wells - *Netflix Inc - CFO*

What we said in the letter would be flat going through this year. I would say with the postal increases that we expect going forward, there'd be slight decline.

Ellie Mertz - *Netflix Inc - VP of IR*

Of the 850K domestic DVD subscribers lost during the quarter, how many of those just dropped the DVD subscription but kept streaming or swapped from DVD to streaming?

David Wells - *Netflix Inc - CFO*

Though migration patterns stayed consistent through Q2, we've got a bunch people that joined the streaming service, some leave and come back as rejoins and a smaller percentage join DVD only.

Ellie Mertz - *Netflix Inc - VP of IR*

Question on the service offering. It seems that you are now more consistently policing the policy of limiting to three simultaneous streaming devices. Do you see revenue with the opportunity for family plans or additional personalization?

Reed Hastings - *Netflix Inc - CEO*

To clarify the premise of the question, there's no limit on devices. There is a limit on for a standard Netflix streaming -- \$8 streaming account on two concurrent streams. So of a couple, you can each watch one different show at the same time, or kids can watch one and adults can watch another, and that's been consistent for several years. So, it's been quite a while.

Ellie Mertz - *Netflix Inc - VP of IR*

Does Netflix plan on streaming current episodes that were aired a few days ago to its customers for a small premium?

Reed Hastings - *Netflix Inc - CEO*

No. We're really focused on prior seasons and helping the current content developers build audiences. This is what we've done with Breaking Bad and Mad Men and other shows that are quite serialized, and that's a good way for us to build out the total ecosystem. The only shows that we would have fully current, we would have current and exclusive, will be our original series, House of Cards, Arrested Development Season Four and similar.

Ellie Mertz - *Netflix Inc - VP of IR*

Question on streaming delivery and OpenConnect. OpenConnect already serves some 10% of Netflix's streaming traffic. Can you break out the cost of hardware deployment so far or characterize the expected long-term cost savings? What pace of transitions from third party CDNs do you expect?

Reed Hastings - *Netflix Inc - CEO*

The cost savings will show up in the P&L more than on the balance sheet. And timing is of over -- it will just continue to grow. The 10% will continue to rise every quarter, and then it partially depends on economics. I'm not sure about two years from now what's the ratio will be. But we'll just continue to invest in OpenConnect. It's a more efficient, more tailored single-purpose CDN for our needs.

Ellie Mertz - *Netflix Inc - VP of IR*

Has Netflix changed its position with respect to paying MSO and telcos for preferred data access? Do you think this will evolve differently for wired and wireless?

Reed Hastings - *Netflix Inc - CEO*

We don't have a position on paying for preferred access and we don't pay for preferred access.

Ellie Mertz - *Netflix Inc - VP of IR*

A few questions on the financial statement. Why did the fully diluted share count increase from 55.5 million in Q1 to 58.8 million in Q2, a 5.9% jump?

David Wells - *Netflix Inc - CFO*

Because we swung to a profit. GAAP accounting would have you bake in the fully dilutive effects of the convert we did in November, and that's not the case when you're at a loss in a loss position.

Ellie Mertz - *Netflix Inc - VP of IR*

What does the balance sheet -- what is the balanced streaming content as of 6/30/12 that are currently reflected on the balance sheet?



David Wells - *Netflix Inc - CFO*

I think I know what you're asking, which is what is the minimum streaming obligations that are reported in our commitments table? Last quarter, in Q1 it was \$3.7 billion of long-term liabilities and obligations not reflected on the balance sheet. That's \$3.8 billion, so roughly flat. If you include the \$1.2 billion in short-term liabilities, the total is \$5 billion corresponding to a \$4.8 billion total in Q1 so again, up slightly.

Ellie Mertz - *Netflix Inc - VP of IR*

At this time, I'd like to turn it back over to the operator and we'll begin taking call-in questions.

Operator

Thank you. (Operator Instructions) Heath Terry, Goldman Sachs. Anthony DiClemente, Barclays.

Anthony DiClemente - *Barclays Capital - Analyst*

Thanks, I have two questions. First, for Reed, maybe you've talked in the past about how TV Everywhere authentication is potentially a big long-term competitor for you. In a lot of negotiations between the content programmers and the distributors, digital, I think, has come into play. And I don't know if it's -- whether it has to deal with ratings declines, you could argue the presence of some programming on Netflix is having a little bit of an erosive effect on linear TV ratings. Or whether it's just that the digital rights themselves, some of the distributors would like to have them in the traditional multichannel bundle. You, I think you said earlier that those negotiations should not or you do not expect those to impact pricing or availability of digital content. And so I just wonder, why not? Why wouldn't they?

Reed Hastings - *Netflix Inc - CEO*

Anthony, it sounded like just one question. You had you said you had two?

Anthony DiClemente - *Barclays Capital - Analyst*

Yes. I wanted to also ask about a comment that you made about profitability. I think you said that it would be either a couple or a few years before you stopped reinvesting profits or contribution margin from the US business into international. And so we're just trying to model earnings going forward, and it sounded like you'd mentioned the Company would be operating at breakeven for the next couple of years, so I wanted to clarify that too.

Reed Hastings - *Netflix Inc - CEO*

Yes, it's true that modeling earnings -- global earnings for Netflix for the next couple of years is a relatively easy task because as the US and our profitable international expansion become positive, we'll tend to turn that money around and invest in additional markets.

Anthony DiClemente - *Barclays Capital - Analyst*

Okay.



Reed Hastings - *Netflix Inc - CEO*

Back to your first question, think of it as it's whoever pays the most money. So, if a content owner wants to make money, the most money possible, they'll offer those digital rights both to us and to the existing distributors. And sometimes exclusive one of the other or sometimes nonexclusive to both, and then it's just a matter of who bids the most for the different content sources. And so they've been active bidders, all the networks have and -- and as well as Amazon, Hulu Plus and others. So that's why I say there's no particular effect to say the recent battles between programmers and distributors because for several years, programmers have wanted to get as much money as they can, which they should. So, there's no particular climate change in the last three months.

Anthony DiClemente - *Barclays Capital - Analyst*

Could one potential climate change be that now that distributors have their own broadband distributional solution, whether it's Comcast X 1 or a different sort of Netflix-like service that's that in the multichannel bundle that now they're clearly -- they are paying so many more -- so much more in overall affiliate fees that they could integrate or bring in the digital rights as a holistic package with the content they're buying already such that they get the hometown discount? I guess that's a concern.

Reed Hastings - *Netflix Inc - CEO*

Yes. It's a concern but ultimately, the programmer -- if we're -- if we offer \$10 million and the programmer will then use that as leverage against the other distributors and say, hey, we want at least \$10 million more. And so again, if you look at it from the producer standpoint, having more bidders, us and the other distributors is good for the content owner because then there's more bidders at the table. And we'd said from the beginning with the TV Everywhere and improving MVPD is our long-term competition, and that thesis remains intact.

Anthony DiClemente - *Barclays Capital - Analyst*

Okay. Thanks, Reed.

Operator

Mark Mahaney, Citi.

Mark Mahaney - *Citigroup - Analyst*

I wanted to follow-up on two things. First, Reed, I know somebody asked you earlier about tablets, but I wonder if you could draw you out just on the impact of smaller tablets. I know we've had very few in the market, but your thoughts on what kind of impact that could have maybe overall to video streaming that would seem to be less cannibalistic or substitutable, whatever the word is, for laptops. And then secondly, could you just over again the personalized plan options or the revenue opportunities new, if you have any that come from the simultaneous -- the extent of simultaneous streaming you're currently seeing amongst your user base? Thank you.

Reed Hastings - *Netflix Inc - CEO*

Sure. On the smaller form factors, if they are Wi-Fi connected, they're used in the home in pretty similar situations to how a laptop might be used. As they come in, it makes a better viewing experience, the battery life is better, they're easier to hold, so that would be a mild positive. There's certainly nothing negative about it. It's just not a revolutionary new way to watch. Whereas, for example, a mobile phone when you can watch out of the home, subject to the data caps, that's more impactful.



And then on personal streams, think of it as today, what we offer is a two simultaneous stream program, and some large families, that doesn't work for. They'll have three or four simultaneous streams going today, and what that family has to do today is get two Netflix accounts, and then they have to partition their devices. Some set of TVs only work on one account and some set of TVs work on the other account. And ultimately, we want to help those families save money by being able to offer a family account, which has more than two simultaneous streams. So, I wouldn't model it as a revenue opportunity. If anything, it would be a discount for those families and a lower price for more consumption. But in whether it's a slight reduction or slight increase, it's very much on the margin.

Mark Mahaney - Citigroup - Analyst

Thank you, Reed.

Operator

Jason Helfstein, Oppenheimer & Company.

Jason Helfstein - Oppenheimer & Co. - Analyst

Thanks. You talked about streaming -- the increased streaming usage helping to reduce -- or increase, actually, member retention. Can you talk directionally -- over time, one would imagine that we get to some type of 75% retention rate, which is typically what we see of subscription services. If you could just talk about directionally are we going in the right place, and do you see that as a potential level over time? And then secondly on the international front, you do talk a lot about the letter. Most of us know about the competition in the UK, but can you talk about the competitive environment in Latin America? Thanks.

Reed Hastings - Netflix Inc - CEO

Yes. In terms of retention, it will sound strange, but we really don't focus on it that much. We want to make it real easy for people to come in and out of the service to give consumers a sense of control. At a high income level, consumers don't care about that, they just leave it on. But at a lower income level, they really value that ability. And so what we focus on instead is total net additions in any period or any geography so that as there's more and more positive word-of-mouth about Netflix, we get more and more net additions.

In terms of Lat Am competition, there's a couple of streaming companies, one in Brazil, one or two in Mexico. Some of them do pay per view, some do subscription, Telefonica has an offering also. So, there's a wide variety of competition, but none of it with a global scale and the ability to invest in the R&D to be able to have really incredible streaming and choosing experiences. We think we have a really big advantage over any single nation firm that tries to compete.

Jason Helfstein - Oppenheimer & Co. - Analyst

Thank you.

Operator

Tony Wible, Janney.



Tony Wible - *Janney Montgomery Scott - Analyst*

I was hoping you could speak to the drop in the amount of content acquisition in the cash flow. You alluded to earlier that the spread between you and Amazon is growing on title count. And it does look like it's up substantially, I guess in the US in the last three months. Are you just getting better terms, or can you discuss why you guys have seen such a nice improvement there?

Reed Hastings - *Netflix Inc - CEO*

I just want to correct you, there's been no reference to relative to Amazon in terms of title count. The references is in terms of viewing hours, as judged by the Sandvine or other reports about Internet streaming. And then do you want to handle the cash flow?

David Wells - *Netflix Inc - CFO*

In terms of the cash flow, basically, the increased commitments would indicate that we were adding content through the quarter, but that content was coming on the balance sheet and off the amount that wasn't recognized or met recognition criteria before. So, I don't think you can conclude from the cash flow that we got better deals.

Reed Hastings - *Netflix Inc - CEO*

And then just adding on to my prior answer on Lat Am competition, piracy is one of the biggest competitors, and I didn't mention that. In each country, there are pretty developed piracy networks, and that's a significant source of competition.

Tony Wible - *Janney Montgomery Scott - Analyst*

Second question is you guys haven't acquired anybody in the past. What would it take for you guys to consider acquiring your way into new countries? And to flip that around, what triggers would you need to see to consider merging with somebody?

Reed Hastings - *Netflix Inc - CEO*

We haven't given that a ton of thought. As you pointed out, in 14 years, we've never acquired anyone. I don't know that we would never do it, but it would be a pretty high bar for us to want to do that versus do what we do best and continue to grow organically.

Tony Wible - *Janney Montgomery Scott - Analyst*

Okay, great. Thank you.

Operator

Barton Crockett, Lazard Capital.

Barton Crockett - *Lazard Capital Markets - Analyst*

Okay, thanks for taking the question. I wanted to make sure I was understanding what you said in your letter correctly about EPIX. You said our online exclusivity expires shortly. Does that mean you've decided not to pay more money to retain exclusivity for the balance of the contract? And if that's in fact your decision, I was wondering if you could talk about why you chose to that?



Reed Hastings - *Netflix Inc - CEO*

Barton, it's something I don't want to add anymore comment to besides what we put in the letter.

Barton Crockett - *Lazard Capital Markets - Analyst*

Okay. Well, if I could try one other question, then, you talk about the Beijing Olympics, what about the winter Olympics? Did that have any effect subscriber growth a couple of years ago?

David Wells - *Netflix Inc - CFO*

It had a small negative effect in terms of as much as we could discern from it.

Barton Crockett - *Lazard Capital Markets - Analyst*

Okay. All right. Thank you.

Reed Hastings - *Netflix Inc - CEO*

You can see, Barton, that people are viewing the Olympics and partially instead of viewing Netflix, which it's harder to tell is do you make that up in the balance of the time period and sort of delay? But there's definitely, during those 10 or 14 days, people are shifting some consumption there, and we saw that on a lesser level with Euro Cup. And when -- an interesting anecdote, when the UK was in the Euro Cup, our viewing was at a certain level and then they got knocked out of the Euro Cup, and Netflix viewing expanded sharply the next day. That's the give you an eye of the substitutability of looking for entertainment. And if my nation's team is competing well, then there's less viewing.

Barton Crockett - *Lazard Capital Markets - Analyst*

If I could follow-up on that, are you seeing more of an impact early on from the Olympics now than you did with the winter Olympics? Or are you --

Reed Hastings - *Netflix Inc - CEO*

The Olympics haven't started, Barton.

Barton Crockett - *Lazard Capital Markets - Analyst*

I know they haven't started, but you brought up caution your guidance.

Reed Hastings - *Netflix Inc - CEO*

Sorry. We won't have -- we won't be able to see the impact for a week or two.

David Wells - *Netflix Inc - CFO*

Yes. To narrowly answer your question, no.

Barton Crockett - *Lazard Capital Markets - Analyst*

Okay. All right. Thank you very much.

Operator

Andy Hargreaves, Pacific Crest.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

I know you weren't planning on talking about the next international market in detail until Q3 reports, but I was just wondering if you could give us any sense for what the initial startup costs might be relative to the other markets that you've entered?

Reed Hastings - *Netflix Inc - CEO*

We haven't characterized that, again for competitive reasons, Andy, but when we announce the market, I think you'll be able to ballpark it reasonably.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

Okay. And then can you give us any update on how you guys are thinking about Facebook integration now that regulatory wise we're in a little bit of a quagmire. Are you changing the process, and do you still plan on going ahead with that this year?

Reed Hastings - *Netflix Inc - CEO*

It's working very well for us in the UK. We're continuing to learn and expand that approach around the world outside of the US. And then as you pointed out on the legislation, it hasn't come out of the Senate at this point, so we are trying to figure out what's the best option there.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

Thanks.

Operator

Doug Anmuth, JPMorgan.

Doug Anmuth - *JPMorgan - Analyst*

Just want to ask two things. I apologize if I missed this, but on Amazon, you've talked in the past about them potentially becoming more of a stand-alone competitor, breaking away with Prime video. Any update there on your view? And then secondly, can you give us any kind of color on how we should think about content costs going forward given that you won't have the exclusivity with EPIX? Thanks.



Reed Hastings - *Netflix Inc - CEO*

Doug, on the Amazon question, I assume they'll eventually break it out of Prime, but our view that they would do that earlier this year hasn't yet proven to be true. So, I don't have any further update on that. And then any cost savings from going nonexclusive on EPIX, we would tend to turn around and invest in other content to continue to have more content. Consistent with the 100 basis point growth in contribution margin.

David Wells - *Netflix Inc - CFO*

That's what I was going to say.

Doug Anmuth - *JPMorgan - Analyst*

Great. Thank you.

Operator

Nat Schindler, Merrill Lynch.

Nat Schindler - *BofA Merrill Lynch - Analyst*

Two quick questions. One, about a year ago, you guys were saying that exclusivity and content usually cost about 1.3 to 1.5 times what just access to the content, nonexclusive rights cost. Is that holding true now that Amazon has become aggressive in buying? And wouldn't you expect it to rise if Amazon is, in fact, buying a lot of the similar content that you are? And then I have another quick question after that.

David Wells - *Netflix Inc - CFO*

Nat, yes, you're right. You would expect it to rise as there are more bidders. And anecdotally, that can happen in some places and not in others. It really depends on the type of content.

Nat Schindler - *BofA Merrill Lynch - Analyst*

Okay. Great. And the other quick question I have is on little bit on your decision on where and which countries to move into and when. I noticed that you're making a move into another European country in Q4. And you made the move -- the big move into the UK after earlier had said that the UK probably wasn't one of the best markets for you to move into early on. As I look at both the UK and a lot of the other European markets, their viewing habits for TV content are -- and their willingness to pay for TV content, based on their history of pay TV are pretty light in compare to the US and Canada. Wouldn't it make sense more to go after countries where they have a bigger history of that and a history of viewing more TV content in general? Much more like the US, maybe something like Australia?

Reed Hastings - *Netflix Inc - CEO*

We see a big opportunity in Europe to provide an on-demand service, the likes of which really have not been seen. It's very different than just another linear ad supported network. And while Australia is indeed a great opportunity, it's relatively isolated. And so for now we're focused on Europe, because we've been extremely pleased with the UK launch and with the 1 million subs in the first 6.5 months. So, we really are feeling quite good about our competitiveness in Europe.



David Wells - *Netflix Inc - CFO*

And I would say, Nat, you were referencing earlier anxiety or worries around the UK competitiveness balanced with the pros of it being a more developed market, more device penetration, more online viewing. And so that was the sort of debate we were having about developed versus developing markets and the relative pros and cons in going into each. And Europe obviously has more developed markets that have much more attuned factors to -- for people to watch online viewing.

Nat Schindler - *BofA Merrill Lynch - Analyst*

Great. Thank you for taking my questions.

Operator

Heath Terry, Goldman Sachs.

Heath Terry - *Goldman Sachs - Analyst*

I was wondering if you could give us a to sense in the markets where you have been able to leverage Facebook integration and obviously realizing that those are all very early markets for you in general, what kind of response you've seen? And then within the US, has Facebook or even social in general, the Netflix Twitter account is particularly active, have those become meaningful channels for either paid or pre-customer acquisition for you?

Reed Hastings - *Netflix Inc - CEO*

Steve, it's Reed. I would say social around the world, both on our efforts in the UK and Ireland and in terms of our usage of social media in the US, have continued to expand like they have for all of our peer firms. I don't think there's anything inconsistent or surprising in that, which is that society is evolving to becoming more socially -- the Internet is becoming more social and we're moving right along with that. In terms of the particular Netflix product integration, it's been very successful in the UK. We've been very pleased with those results, and now we're trying to -- we are continuing to try to figure out how to make it legal for US consumers to get access to that.

Heath Terry - *Goldman Sachs - Analyst*

Got you. Thank you.

Operator

Richard Kang, Tiger Asia.

Richard Kang - *Tiger Asia - Analyst*

Reed, could you comment briefly on any future plans as it has to do with applications or apps, specifically in app developers, who might help drive viewing and users into Netflix by creating their own communities or other types of services that ride on top of Netflix's platform?



Reed Hastings - *Netflix Inc - CEO*

Richard, we don't have any near-term plans like Spotify to develop an app ecosystem. We think with video and its consumption patterns, we're better off on making our experience better and better. And that's what we're focused on.

Richard Kang - *Tiger Asia - Analyst*

Got it. Thank you.

Operator

Vasily Karasyov, Susquehanna Financial.

Vasily Karasyov - *Susquehanna Financial Group - Analyst*

Thank you. Good afternoon. Just wanted to clarify first, did I understand correctly that when you were answering Anthony's question that you said you most likely will not be profitable in consolidated basis because of international investment for 2013?

Reed Hastings - *Netflix Inc - CEO*

We haven't guided to that. What I said is consistent with what we've said for the last about half dozen calls, which is our basic model is to become profitable again on a quarterly basis as we have last quarter and expect to, this quarter, Q3, and then to add an additional international market which generally drives us negative slightly. And then through growth in the profit streams gets us back to positive, and that's what meters our rate of international investment is to stay approximately breakeven or in and out of probability.

David Wells - *Netflix Inc - CFO*

And I had said earlier that the three conditions upon which we'd launch another market would be that global breakeven, that we were pleased with the progress that we're making in our existing international markets and that we had identified a third market -- an additional market, the third condition being we'd identified an additional market.

Vasily Karasyov - *Susquehanna Financial Group - Analyst*

Thank you. Would it be fair to say that you have more than one target market in mind at this point?

Reed Hastings - *Netflix Inc - CEO*

Our basic view is that as the Internet becomes very global and as an example of this, if you look at YouTube viewing around the world, that there's no reason why an on-demand service for movies and TV shows like Netflix shouldn't be highly successful. In general, China would be difficult for us, as you would all appreciate, and then any nation that has extreme online piracy would be difficult. But outside of those two conditions, most of the world will have services like Netflix, and we would like to be that service.

Vasily Karasyov - *Susquehanna Financial Group - Analyst*

All right. Thank you very much.



Ellie Mertz - *Netflix Inc - VP of IR*

This is the last question for today. Reed, would you like to offer some closing remarks?

Reed Hastings - *Netflix Inc - CEO*

Great, want to thank all for your support. We're extremely pleased with our US streaming profitability growth, our contribution margin is expanding very nicely and shows us and every one what can happen in scale. And now we're focused on getting our other markets to those same scale and profitability levels as we continue to invest. So, thank you very much.

Operator

Ladies and gentlemen, thank you for participating in today's program. This concludes the program. You may all disconnect.

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