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EDITED TRANSCRIPT

NFLX - Q2 2013 Netflix, Inc. Earnings Conference Call

EVENT DATE/TIME: JULY 22, 2013 / 10:00PM GMT

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CORPORATE PARTICIPANTS

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David Wells *Netflix Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Rich Greenfield *BTIG - Analyst*

Julia Boorstin *CNBC - Media and Entertainment Reporter*

PRESENTATION

Erin Kasenchak - *Netflix Inc - Director, IR*

(audio in progress)

Erin Kasenchak, Director of Investor Relations. Welcome to this live video interview for our 2013 second-quarter earnings results. We may make forward-looking statements during today's interview and results may differ from those statements. Now, I'd like to turn it over to Reed Hastings, our CEO.

Reed Hastings - *Netflix Inc - CEO*

Thanks, Erin. We've focused on efficient and effective investor communication for a long time. We worked through our shareholder letter, our long-term view. In terms of the Q&A, we've always admired the fireside chat format at investor conferences at being the most dynamic and interesting. This is our attempt to bring that value to the broad, online public.

Now, we are on our webcams on our laptops and on YouTube, so I hope the quality is acceptable, and we look forward to any suggestions from you afterwards. With me, today, from Beverly Hills is Ted Sarandos, our Chief Content Officer.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Thanks, Reed. I'm glad to be here today.

Reed Hastings - *Netflix Inc - CEO*

Thanks, Ted. Also with me is David Wells, our CFO.

David Wells - *Netflix Inc - CFO*

Thanks, Reed. I think at this point, we will start the questions, so I am going to turn it over to our first interviewer, Rich Greenfield from BTIG.

Rich Greenfield - *BTIG - Analyst*

Actually, I think we are going to have Julia start off. Julia, why don't you kickoff.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Thanks, so much. Julia Boorstin, here, from CNBC.

I wanted to say that Rich and I have been emailed and tweeted a wide range of questions from a range of institutional investors, individual shareholders, sell-side analysts, and also other companies in the media industry. Now, because there was a lot of overlap in the questions, we are not going to be attributing individual questions, but rather, trying to compile them all and get through as many as possible. We were emailed a very wide range and a lot of questions. So, we are going to get right to it.

The first question is about the format of the call. Reed, this question is for you -- you alluded to it a little bit, but there has been a lot of criticism about your decision to format the call this way. How do you address concerns that it actually minimizes the ability of investors to communicate directly with you?

Reed Hastings - *Netflix Inc - CEO*

I think we should process that after the interview and let's see if it's productive and useful for investors and see what they think.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Rich?

Rich Greenfield - *BTIG - Analyst*

Reed, why did do not reach the top end of your domestic sub guidance? We've talked about where you've seen the success of your Original programming. You have been Emmy nominated. You have gotten a lot of free marketing in the quarter. And yet, you did not get up to the top end of your sub guidance. Could you give us a sense of why that didn't happen?

Reed Hastings - *Netflix Inc - CEO*

Yes. When we do our forecasting in the beginning of the quarter, when we know all of the factors going into that, we try to set the range so that we come in in the middle of the range, as we did. So, we are really happy with the progress in the business. We are happy that net adds were higher than a year ago in our domestic business and much higher on the international business. So, we are feeling quite good about the business.

Rich Greenfield - *BTIG - Analyst*

You alluded to the impact of Arrested Development in the quarter, but you didn't actually specify how much it had. Could you give us a sense of how many of your subscribers came from adding that programming?

Reed Hastings - *Netflix Inc - CEO*

When we look at Original content, whether it's House of Cards or Arrested Development, we are in the very early innings of this. We are figuring out how to promote them. What the ongoing value is. What we see is, if we do it right, these will turn into real franchises -- that is, House of Cards, Season 2; Orange, Season 2, Season 3, Season 4 will be tremendous assets for the Company.

Arrested was a unique look forward because it already had a developed brand and we were bringing out Season 4. What we did see was a little rise in gross additions, which translate into net additions, more than the weekly pattern would have suggested. But, it was not particularly -- it was enough to move our net adds higher than last year, but it was not tremendously significant in the short term.

In general, remember that people subscribe and retain with us for a variety of content, not just a single show. So, they might be -- become that Arrested Development was the excuse to join, but then they start watching all of our other great content, so think of it as part of the content mix.

I don't know, Ted, do you want to add to that at all?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

I would point out that with every series we've launched, both the viewing audience and the total hours viewed has grown sequentially with every single -- with every series that we've launched. Remember, we launched from ground zero with the first -- both in the concept and in the show itself. Then, continue to grow it and grow it and grow it.

So, I will agree with Reed, these are going to have very long-term implications, that we imagine. And, we have been saying from the beginning, that they have subtle impact on subscribers over time because you are realizing it with things like brand halo and reductions in churn that happen subtly and over time.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

But, you chose to single out Arrested Development. Does that mean Arrested Development was responsible for, say, 15% of the subscriber growth this quarter? Can you give us any number to actually quantify what you indicated in the letter?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

I believe we point it out because it breaks the seasonal pattern in a way that can be attributed more directly to that.

Reed Hastings - *Netflix Inc - CEO*

Julia, when a subscriber, a new member joins, they don't say it's because of Arrested. There's a whole wide variety of reasons. Arrested, again, is unique because we are starting with an already created brand. The general case with Hemlock, with Orange, with House of Cards is for us to be the first season in debut. So, think of Arrested as an unusual, a nice opportunity, but the general case for Netflix Original programming is more like House of Cards, Hemlock and Orange.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Does that indicate that you expect to see an uptick for House of Cards' second season, for example?

Reed Hastings - *Netflix Inc - CEO*

I think would probably see a little bump there in our numbers. That would make sense. Hopefully, by the time we get to Season 3, 4, 5, if we are fortunate enough to get there, then we've turned it into a Harry-Potter-esque global massive phenomena -- when is the next season coming? Then, we certainly would. Again, we've only made some progress on that. We've got to see -- we've got to make Season 2 as great as Season 1.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Julia, I would even point out that even the most iconic TV brands, like The Sopranos and Seinfeld, took several years before they became brands.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

(Multiple speakers) sorry, go ahead --

David Wells - *Netflix Inc - CFO*

If I can add to their comments, this is David. We've said consistently, and I've said consistently, that it will take several shows for folks to be engaged in Arrested Development and other types of our Originals. It's not going to be one show. If you think about whether you join HBO or Showtime because of one or two shows, Game of Thrones is the only example where people have thrown out that it is a single show. Otherwise, it's multiple shows. It will take us a while for our Originals to get there.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Moving on to some more questions about the most recent quarterly report. Your investor letter indicates that Q4 margins will decline dramatically despite the fact that you project margins to improve 400 basis points for the whole year. Is this the beginning of a problematic trend in the fourth quarter?

David Wells - *Netflix Inc - CFO*

I don't think that we put in the letter any implication that our margins would decline. What we are talking about is our progression, our expansion of margin, and the fact that over the last six quarters, we have actually over delivered on our target of about 100 basis points a quarter. Content deals are lumpy, and it is hard to predict that and also plan to that gradual expansion. So, there are quarters where we are going to be over; there will be quarters we are under; but on average, we will deliver about 400 basis points a year, as long as we are able to continue to grow at the rates that we have seen.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

But adding up the math, the fourth quarter does show -- is going to show a decline in margins. I guess my question is, how much of that is due to an increase in additional content spending compared to an anticipation that you're going to have to accelerate the amortization of the Originals in the fourth quarter?

Reed Hastings - *Netflix Inc - CEO*

Julia, for the fourth quarter, we are targeting a little over 400 basis points over the fourth quarter one year ago. That doesn't apply a reduction, and certainly not a dramatic reduction, of the margin, so there's a math error in the question.

Rich Greenfield - *BTIG - Analyst*

Reed, to be clear, we had a lot of investor questions who thought the 400 basis points was 400 basis points for the full year, not 400 basis points in the fourth quarter. They were looking at your out performance in the first three quarters, and assuming that meant a very large falloff in Q4 to stick to the 400 basis points for the full year.

Reed Hastings - *Netflix Inc - CEO*

I see. That's where a good Q&A session like this is useful, so let us disambiguate that. We are looking at a quarter over quarter, so our target for the fourth quarter of this year is 400 basis points ahead of the fourth quarter of last year.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

So that 400 basis points is not for the full year, just to clarify? Because, there was a lot of confusion among analyst questions and investor questions.

Reed Hastings - *Netflix Inc - CEO*

Correct. Apparently, we accidentally created that misunderstanding with the per year, but meaning quarterly year over year.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Got it. Thank you. Rich?

Rich Greenfield - *BTIG - Analyst*

When you look at Originals, you've called out a couple of them in terms of House of Cards and Arrested Development. You've got a bunch of those still sitting around in the pipeline, and now you've got Orange is the New Black. When you look at the Q3 guidance for subscribers, is there a benefit from Originals? Because, you seem very excited about Orange is the New Black. How do we think about that?

Reed Hastings - *Netflix Inc - CEO*

Ted, why don't you take this one?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Sure. Rich, like I mentioned, I think that we have had this compounding positive effect. They're subtle effects, but they are compounding, meaning that when we launched Orange is the New Black, surprisingly, it drew as big a first seven-day viewing as any of the Original series. It actually had been growing every time, which would have to lead you to believe that people are taking more confidence with the idea of Netflix Originals, which is creating some excitement for upcoming seasons, as well, and upcoming new series, as well. The brand is starting to mean something to viewers already, even though we only started doing this in February. That's what we are enthusiastic about.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Now obviously, Netflix is proud of its Emmy nominations. Why don't you tell us how many people watch those shows that were nominated.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

(Laughter) we've said publicly, and we'll continue to say publicly, that we are not releasing viewing numbers. Our actual ratings would be apples and oranges comparison to what happens on a network. We view -- weight the viewing over a very long period of time.

I will tell you, though, that you should look at our renewal of a season -- of a show to a second season as a very positive sign. Because, if we are renewing shows that people aren't watching in big numbers, then we are creating a huge opportunity cost in our content spend. In other words, we won't have money to spend on things that people watch. These shows are performing really well for us. They are hitting our numbers with remarkable precision, in terms of what we forecasted. Enough so, that we had confidence to renew Orange is the New Black based on our viewing models, even a few days before we launched the show.

Rich Greenfield - *BTIG - Analyst*

Final question on Q1, and this is for David, specifically. There is a footnote 1 that talks to a restatement of your contribution margins related to an SG&A shift. Could you explain why that was made and what happened?

David Wells - *Netflix Inc - CFO*

Sure. That's related to our global spending on marketing overhead, so people, it's really marketing folks. They are working on projects, on branding projects, that are for the Netflix brand across the globe. So, they are not working on things that are specific to a particular territory or operating segment, so we felt like we wanted to treat them like we do our other content folks that are making our content deals and we treat them as of global cost. Those costs were moved down from the marketing line, which was a cost of revenue, down into a G&A line.

Rich Greenfield - *BTIG - Analyst*

Now, moving onto actual questions in categories, we are going to try to break these up into big topic categories. The investor letter starts off by talking about a saturation, based on competition. I wonder since, Reed, you've talked about this 60 million to 90 million potential for Netflix -- why are you even talking about saturation given where Netflix is today?

Reed Hastings - *Netflix Inc - CEO*

I think we never know when and how saturation will hit, and what we are trying to be clear on is there's a couple of different forces. One is that our content is getting better, our service is getting better; and the other is, the larger we get, of course, the harder it is to grow. Also, the longer time goes by, the better competitors are. So, those are the opposing forces. Given those forces, we are extremely excited to have our net adds be at the same level as last year because that implies that there is no near-term saturation.

Rich Greenfield - *BTIG - Analyst*

Are you still comfortable with the 60 million to 90 million ultimate market potential?

Reed Hastings - *Netflix Inc - CEO*

We are. We are feeling very good about that. Because, what happens is, by the time we get to 40 million and 50 million, we get the content better and the service better. So, it's not 60 million or 90 million for the current service, it's 60 million or 90 million for the future service that's much improved, with maybe, a lot more Originals and incredible streaming.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Many investors have shared a concern that virtually everyone in your potential market has already tried Netflix at least once, so you have very few actually new customers. What is your level of churn?

Reed Hastings - *Netflix Inc - CEO*

What we really focus on is the net adds. Because someone has tried Netflix before, they are probably more interested in trying us again, as the contents get better, as the streaming gets better, as the playback software and the devices gets better. So, there's lots of people who tried us, and then they will try us again to see if we meet their future needs. So, we are feeling very comfortable about that.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

I understand you stopped reporting churn. Can you tell us anything about the churn and what that might reveal about future growth?

Reed Hastings - *Netflix Inc - CEO*

I can tell you that as the CEO of Netflix, I focus, myself, I don't even look at the churn numbers, essentially, I am looking at net adds all the time. Because, you get various tradeoffs, and really, what we care about is total growth. So, it's bringing the world in line with how management looks at it, which is in terms of net additions, which we do check every week, every day.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

(Multiple speakers) no, go ahead, Rich.

Rich Greenfield - *BTIG - Analyst*

Consumers are now watching over 90 minutes of Netflix a day. Why is that household churning? What else do you need to do if you already have 90 minutes of household viewing per subscriber in the US?

Reed Hastings - *Netflix Inc - CEO*

That household that's watching 90 minutes a day probably isn't canceling, but that's an average, so think of it as a bell curve of usage. The people at the lighter end that are not using Netflix much, then they are more prone to cancel it than someone who's watching a lot. So, we constantly try to make the service better, which is what we've been doing over the last five years.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

We received a number of questions and concerns about your free cash flow. Over the last few quarters you've had a disparity between net income and free cash flow, suggesting that you are really making an investment in your streaming library content. But the question then is, what is the duration of the content that you are investing in, and when should we expect it to run through the income statement?

David Wells - *Netflix Inc - CFO*

I will probably take this one. This is David. We've been very clear and very transparent about the fact that our content investments are going to run ahead of our P&L expense and weigh on our free cash flow. We were pleased this quarter to actually flip to positive. Likely, we will continue to make investments in Originals and other content that will continue to weigh on our free cash flow.

We are very comfortable with where we are today. We think that the viewing that follows from those content investments -- our accounting has to follow from that viewing, to the extent that the industry is set up that more of the money is paid up front in order to fund production. That is

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something that we can only affect a little bit. We have to be competitive buyers in the industry, so we have to meet those payment terms, and a lot of these deals are more cash-up-front loaded.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Certainly, but some investors who we have spoken to calculate disparity between net income and free cash flow at over $2 per share. Will we see that pressure EPS?

David Wells - *Netflix Inc - CFO*

I'm not sure about the $2 per share. What we've said is that our free cash flow runs ahead of our P&L expense, about 20%, so the ratio of cash out to P&L expense can run 20% above that P&L. That's typically holding, even with some of our more cash-up-front Originals deals. You will see some of that start to unwind as we get older and a lot of the deals start to mature down the road. While we are expanding content, you should expect, and investors should expect that to continue to weigh on our free cash flow.

Rich Greenfield - *BTIG - Analyst*

David, when you look at the Original programming, the amount of spend versus the amortization -- your website spends a lot of detail going into how that's amortized. What is the actual cash outlay? You talked about it being higher. How should we think about how the cash for these Originals, and even some of your new deals like DreamWorks, how does that actually was flow into your actual cash position as we think about your balance sheet?

David Wells - *Netflix Inc - CFO*

They are a little bit different. Generally, we make payment partially upon delivery and then another section -- it depends on the deal, and we don't talk about deal specifics, but illustratively, it can be 18 months, it can be 3 years, it depends on the license period. Again, it really depends on the delivery of that content and when it comes in. For output-style deals, that really depends on the size of the box office card that we are paying. Again, it depends on the content as it comes through.

We've been fairly conservative, I'd say, in terms of preparing for this. We raised debt earlier in the year. We restructured some debt. We feel pretty good about our cash position. We put in our long-term letter, depending on the expansion of Originals, we may need more capital down the road, but right now, we are fine.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Rich, I'd say, too, that we've been able to get very favorable cash terms from our suppliers on most of our deals. And, I'd say that the more high-profile the programming is, the more likely it is Original and exclusive, the cash outlay is accelerated versus some of the very deep catalog that pays out very smoothly over several quarters.

Rich Greenfield - *BTIG - Analyst*

When you drive more subscribers at a lower price, or generate a higher profit margin at a higher price -- basically, why is $7.99 the right price?

Reed Hastings - *Netflix Inc - CEO*

I would say $7.99 is pretty close to the right price. I don't think we could be certain that at $6.99 or $8.99 it would be a little bit better or a little bit worse. Once you've picked a price, there is a tremendous value in consumer stability, and we're growing very strongly at the current price, so we feel great about that situation.

Rich Greenfield - *BTIG - Analyst*

But, there's an overwhelming number of questions from investors and other analysts of -- are you going to be forced to raise price because you literally can't afford your content commitments? So, either you need to raise equity or you need to raise the price of your service.

Reed Hastings - *Netflix Inc - CEO*

If you look over the past three years, we have raised the contribution margin in the United States business from sub 10% to over 20%. So, I think there's plenty of evidence that we can grow revenue faster than we are growing content cost.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

But a specific question that was asked by a number of people is -- given the negative operating cash-flow trends, obviously cash flow is positive this quarter, but given those trends and the high cost for Original content and also exclusive content, what is the probability that you would either be forced to raise debt or subscription prices in the next 12 months?

Reed Hastings - *Netflix Inc - CEO*

Let's separate the two factors. One is domestic, where we are hugely profitable and growing very well. The other is international, where we are growing extremely strongly. Revenue was up 155% over one year ago, but it has negative P&L, we're in investment mode. We've got the strong US business supporting the investment in international.

In terms of the likelihood of raising debt or prices, we don't have anything more to add to that than what we said, which is we are very comfortable where we are in the $7.99 price point, and we are growing very strongly. In terms of debt, it would be pretty unlikely in the next 12 months.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

I guess looking beyond that, beyond the next 12 months, over the next couple of years, many investors and analysts who emailed in said they believe you will need to execute a stock sale to pay for your content obligations. What is your outlook, in terms of your plans for potentially a secondary stock offering in the next three to four years?

Reed Hastings - *Netflix Inc - CEO*

This is too far off to speculate on. At this point, what we can say is what we've said.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Would a price increase be a way to avoid a capital raise?

Reed Hastings - *Netflix Inc - CEO*

We're very comfortable with our $7.99 price point and with the growth that it generates.

Rich Greenfield - *BTIG - Analyst*

Shorts believe that your stock is exceedingly expensive. When you look at the valuation of where you are now, how do you get comfortable with the growth potential of your stock from these levels?

Reed Hastings - *Netflix Inc - CEO*

I think management is probably not the greatest judge of their own stock price, so we try not to comment specifically on that. We try to provide lots of information to investors; and then, there's a natural process, through that, of the price getting set. What we focus on is how to grow the subscriber base, how to expand internationally, how to improve the content, and those are all the things that we're focusing on.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

For investors who have been on a roller-coaster ride with Netflix over the past two years, what would you say to tell them, or reassure them, that what happened two years ago is not going to happen again?

Reed Hastings - *Netflix Inc - CEO*

Stocks go up and down. Our stock has been so volatile. A year ago, we were at $80, now we are over $200. Five years ago, we were at $30. We went public at $7.50. The general trend is quite positive, but there are a lot of ups and downs, and it's been a very volatile stock because we are growing so aggressively. We are choosing a business strategy which has us put, essentially, all of our domestic profits into international expansion. That's the right move, but it definitely takes a strong stomach on the part of investors.

Rich Greenfield - *BTIG - Analyst*

Reed, really following up on that international point, what is the strategy? Do you want to, essentially, grab as much market share over the next five years as you can without regard to profitability? Or, do think you are actually start showing meaningful international profitability before going into too many more markets.

Reed Hastings - *Netflix Inc - CEO*

No, and our strategy, as same we put in the long-term letter, which is we are investing, substantially, all domestic profits in international expansion, and we think that's very smart. If you look at our international growth, it's tremendous. We think there's a huge opportunity around the Internet and international markets. We are investing for the long term in that, and I think we have been very clear on that for almost three years now.

David Wells - *Netflix Inc - CFO*

Yes. The only thing I'd add to that, Rich, is that we have demonstrated good progression, in terms of operating losses, reductions in international. We are 25% down year over year. And we are very pleased, as Reid said, with the growth in those international markets. It is more about the progression of our existing markets and the path we are on than it is about an overall line.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

I could also add, too, that the success we are seeing with our Original programming, we are seeing throughout our international markets as well. That proportionally to our sub base, our subs overseas are excited about these shows at, roughly, the same levels as they are in the US.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Shifting gears over to your licensed content spending. With two of the last three DreamWorks Animation's films disappointing at the box office, underperforming DreamWorks Animation's average, do you have an out of the big deal that you announced with DreamWorks Animation?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

For -- I'm sorry, Julia, are you talking about the series deal or the film output?

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

The series deal and the film -- both -- the larger deals.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

I'm very comfortable with DreamWorks' performance at the box office. Even this weekend, yes, Turbo opened a little soft, but it came out with cinema score ratings of A, with very good word of mouth, likely to hold up -- likely to continue to expand the box office. Croods was a nice little hit, actually, at the end of the day for DreamWorks. There's a rate card that regulates the fee for those films relative to their box office performance. We are thrilled with DreamWorks and the performance of their films and the quality of their films, and they translate to very high viewing on Netflix, even in movies that don't perform as well at the box office.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

The fact that Turbo has been such a box office disappointment, especially compared to all the other DreamWorks Animation movies, doesn't that diminish the value that DreamWorks Animation content on your platform? You have said that it would be a game changer that this additional content has entered -- doesn't this diminish that?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Julia, if it does, it's reflected in the rate card. The rate card adjust up and down with the performance of the films. As far as the series deal is concerned, these are very iconic characters that tend to last a long time -- way beyond opening weekend performance. Our series will launch after the posted DVD release of these films, so they get a whole second wave of marketing out of them, too.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

I'm sorry, go ahead, Rich.

Rich Greenfield - *BTIG - Analyst*

Ted, when you buy content, do you see a point where you are going to be buying globally versus having to buy in the US, buying in the UK, and every single market -- when can you scale buy globally?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Increasingly, all of our Original deals we are doing globally. We have been doing all of our independent non-studio deals globally, and we are doing much more multi-territory licensing as well. Sometimes, global plays out in our favor, and sometimes you don't really achieve the scale of it. Right now, we are trying to wade through that and see where we can pick up global efficiencies.

Rich Greenfield - *BTIG - Analyst*

Can you give us an example of (multiple speakers).

Reed Hastings - *Netflix Inc - CEO*

Rich, even when we are global we'll -- for example, in Asia, where we are not currently, we will generally sell off the rights there. So, even when you talk about global, if we are not exploiting it globally, it's really multi regional.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Correct.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Moving on to -- quickly, before I move to Original programming spending -- can you tell us how many subscribers quit Netflix after you chose not to renew Dora the Explorer and the other Viacom content?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

You saw it in the net adds, we grew.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Moving on to the Original programming spending, Netflix often draws a comparison to HBO. Unlike HBO, Netflix does not own the content, so it doesn't profit from licensing it to other outlets and also doesn't have exclusive rights. For instance, House of Cards you can buy elsewhere, though Netflix does have the streaming rights. How do you justify reinforcing this parallel to HBO when HBO does have a different business model?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Julia, most original programming originates in this way, which is you want to hedge your bets a little bit on building the confidence and building up before you build out the infrastructure. So, you step in and do more licensing deals, which is how Showtime does most of their deals, which is how HBO did in their earliest days, how AMC did in their earliest expansions, so this is not unusual at all. And, the more confidence we build, the more likely we are to take a full ownership stake and to build out more infrastructure around it.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Does that mean (multiple speakers).

Rich Greenfield - *BTIG - Analyst*

Have you started to build that infrastructure, that is?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

We are managing a broader set of rights today than we used to, for sure.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Does that mean you do -- (multiple speakers).

Reed Hastings - *Netflix Inc - CEO*

Sorry, it's Reed here. Think of it as a broad expansion, which is HBO has a lot of licensed content, for example, all the movies. So, it's only the originals and only some of their originals that they own. It's natural for us to grow into that over the next couple of years, so it's part of a long-term view.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Do you have specific plans to move into full ownership in the near term?

Reed Hastings - *Netflix Inc - CEO*

Absolutely, it's something we are looking at. There's so many gradations between what full ownership is and every territory. But think of it as, over time, we will do more and more of the content will be more and more exclusive to Netflix. While we were getting started, it was really smart for us to work with Media Rights Capital and Lionsgate and others to be able to leverage their skills and competencies.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Rich?

Rich Greenfield - *BTIG - Analyst*

Reed, do you think that you have a structural advantage in creating original programming versus your peers? Whether the releasing pattern, whether it's the data, or whether it is the fact that you are commercial free?

Reed Hastings - *Netflix Inc - CEO*

We have some advantage in creating it, but I think the biggest advantage we have is in matching with the content and distributing it, essentially, monetizing the content. You can see that with the breadth of our success. So, one view of our four for four in our starting, or five for five if you include Lilyhammer, is Ted's God's gift to programming, and I think that's probably true. The second part of it is also that we've got this online performance matching where the content is selectively promoted to each subscriber appropriately, and that helps tremendously.

It's not really important for us to tease apart which is more true. We want both excellent, excellent programming, and we want to do amazing promotion, and we get stronger from that without worrying too much about which side is contributing more or less. You do see that Ted has an Emmy next to him in the frame, and he's got a little story for you in that.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Yes, the Emmy we brought along today I think is a great example of Netflix, which we strive to be excellent as both a technology company and an entertainment company. Fitting to that, this Emmy was actually awarded to Netflix on the technology side last year for the advancement of television. So actually, the first Emmy came from the tech side of Netflix.

Rich Greenfield - *BTIG - Analyst*

I guess I don't understand, how do you define a hit? You said Ted is five for five, Reed -- how do you know Ted is five for five?

Reed Hastings - *Netflix Inc - CEO*

The easy one is a hit is something we want to renew, and the five for five is we want to renew because the economics for us are good.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

A question about your content cost -- just to follow up on that, how do you know you want to renew it? Is it the percentage of your subscribers who are watching? Is it the subscriber bump? (Multiple speakers) insight into how you know that you want to renew?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Relative to how else we would have spent the money, relative to spending it on licensed content -- did we get an increase in viewership, do we get an increase in some of the intangibles like brand halo, publicity, and to bring the brand more in focus with our consumers. So, relative to how else we would have spent the money on other programming, we think it was a big hit.

By the way, without giving total -- without giving ratings numbers, I will tell you every one of these shows are drawing TV-size audiences. You know that House of Cards is a hit because when you walk into Starbucks people are talking about it. You know when the show is being spoofed at the White House correspondents dinner and 3,000 people are laughing at the slightest references to the show, you know that people are watching it, and you know people are talking about it. Without the precision of a number, you know that these shows are a hit, too.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

We are going to keep on asking for numbers --

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Okay.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Some day, Ted, you will give one to me.

A question about content costs -- seemingly every network, cable and broadcast, and all of these new digital channels are all spending aggressively on original programming. Doesn't that threaten to drive your content costs spiraling higher? What kind of a threat is that to your markets?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

How would it drive them higher?

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

If there's so many people competing for content.

Ted Sarandos - *Netflix Inc - Chief Content Officer*

For --

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

There are new buyers for content (multiple speakers).

Ted Sarandos - *Netflix Inc - Chief Content Officer*

With so many people producing original programming, it creates a lot of competition in the market for licensed programming in the season-after model. In terms of competing for original programming, I am much more comfortable, to Rich's earlier question around similar structural advantages about not having to have a lot of performance pressure on a show in its first week, which actually drives the ability for consumers to find the show over time before we have to pull the plug on it, the way many other broadcasters are forced to in linear television.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

To raise a question about competition, you have Amazon, which is investing at $1 billion in licensing content. You have Hulu, which has got $750 million from its parent companies to spend on content. The influx of all of this cash for content, both licensed and original, doesn't that threaten to push up prices?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Maybe. I could tell you that in the more exclusive deals that we've been negotiating, the one thing that's nice about that is you get to know what the walk-away prices are. I can tell you in every one of those cases, we have been comfortable at the prices we walked away from, and comfortable at the level of the pricing that our competitors are paying for that content. So yes, there's definitely some competition in the marketplace, which does raise the prices, which is good for the producers, and eventually, good for consumers, too.

Rich Greenfield - *BTIG - Analyst*

You know when you --

Reed Hastings - *Netflix Inc - CEO*

I will add to that, it's great for content owners and it's great for creators that there's this renaissance, particularly, in serialized TV. So, on one hand it's tough on us that Amazon and Hulu and others are bidding, but there's so many great stories to be told that it's exciting. If the prices are going to go up, then we, as one of the major scale players, have a big advantage. So, it's good for the creators, it's acceptable for us, and we are seeing this total renaissance in television.

Unfortunately, I have to tell you we are down to about two minutes left. I did set this up as a 30 minute view. If it is very successful and investors like it, we will try to do a longer session next time. Let me hand it back to you for the closing two minutes.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Okay. I hate to say we were emailed so many questions by investors and analysts, I wish we had a little bit more time. I am going to ask a quick question about competition. You mentioned Amazon and Hulu. Both of them are stepping up their investment in spending. What kind of threat do they pose to you in the next -- starting, I would say, starting in 2014, once we start seeing the impact of that?

Reed Hastings - *Netflix Inc - CEO*

We don't really know. We always take them very seriously. They are very successful. If you look at Showtime and HBO, when Showtime does great work, it doesn't take away from HBO. We think that Hulu and Amazon will do great originals. It will grow the whole Internet TV market. And then, what controls our destiny is, do we do great programming? Do we have a great user interface? Do we have incredible streaming? So, we really focus on maximizing that opportunity by making our service the best it can be.

Rich Greenfield - *BTIG - Analyst*

Reed, you talked about incredible streaming quality, but the issue really is, most of your viewing occurs on fixed-line connections because that's where the quality of the experience is good and international -- I'm sorry, wireless isn't that good. Do you think that over the next few years we are going to see a sea change in the wireless industry? [SoftBank Omotesando] is putting a tremendous amount of capital buying Sprint. Do think you're going to see a big shift in your business towards wireless over the next few years?

Reed Hastings - *Netflix Inc - CEO*

Think of it like tablets, as tablets have come about they've been a growing proportion of our viewing, and that helps the ecosystem, better and cheaper connectivity, more competition for broadband -- that's all very positive. But, these are gradual multi-year affects. 5 or 10 years from now, consumers will have incredible devices, incredible broadband at low prices, and that's very favorable in the long term, but I don't think it's a short-term catalyst.

Rich Greenfield - *BTIG - Analyst*

Is tablets even 5% of your viewing today?

Reed Hastings - *Netflix Inc - CEO*

We don't disclose the specifics.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Reed, a question about the business that you started off with -- DVDs. Many investors have pointed out that you seem to be allowing your DVD business to atrophy. Do you plan to shut down that legacy DVD business?

Reed Hastings - *Netflix Inc - CEO*

No. We've got over seven million members who love the service. It's got incredible selection -- every movie and TV show ever made. It's got a great part of the value equation for over seven million members, and that will go on for a very long time.

Rich Greenfield - *BTIG - Analyst*

Reed, one last content question --

Reed Hastings - *Netflix Inc - CEO*

Final question, go ahead.

Rich Greenfield - *BTIG - Analyst*

One last content question because we got it from a lot of people. You've gone into original TV series -- a lot of people are asking, would you go into the movie business and create movies? Would you create talk shows in the evening like a Jay Leno type show? Would you do a news program like the evening news that people could watch for 24 hours on the subscription service? What other content makes sense for Netflix?

Ted Sarandos - *Netflix Inc - Chief Content Officer*

Rich, in the letter, we mention that we are going to expand in the coming months into original standup comedy specials and documentaries that will premiere on Netflix and be exclusive to Netflix. There is no reason we wouldn't do some of those things that you've listed, including movies, if we could bring to it something like we did with Original series -- kind of change the distribution model in the favor of the consumers with things like launching the whole season at one time, and things that give us advantages over other forms of distribution.

Reed Hastings - *Netflix Inc - CEO*

If you look at HBO and Showtime, they also do quite a bit of sports programming and live sports, so they're basically in the membership-happiness business. Now, we don't anticipate getting that far from our core brand, but it's a very flexible relationship where we can have lots of types of content over the next 5 or 10 years, if it makes our subscribers happy.

We are fundamentally in the membership-happiness business, as opposed to in the TV-show business, so we do have a lot of flexibility. In the next -- in the short term, we are focused on learning this craft bit by bit and having our current shows be wildly successful.

Julia Boorstin - *CNBC - Media and Entertainment Reporter*

Can you tell us how many more originals you plan to launch over the next two years and how much you plan to spend on them?

Reed Hastings - *Netflix Inc - CEO*

Not precisely, but we can say we are continuing to expand that, and it's a great wrap-up question. I want to thank all our investors for participating in this. We look forward to your feedback on the format. We will try to keep on improving it to make it efficient and effective for all of you. Thank you very much.