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NFLX - Q1 2013 Netflix, Inc. Earnings Conference Call

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Doug Anmuth *JPMorgan - Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the Netflix first quarter 2013 earnings Q&A session. At this time, all participants are in a listen-only mode. Later, we 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 Erin [Kuzenchek], Director of [Viar]. Please, go ahead.

Erin Kasenchak - *Netflix Inc - Director of IR*

Thank you, and good afternoon. Welcome to the Netflix first quarter 2013 earnings Q&A session. I'm joined by Reed Hastings, CEO, and David Wells, CFO. We announced our financial results for the first quarter at approximately 1.00 p.m. Pacific time today. The shareholder letter and the Q1 financial results and the webcast of this Q&A session are also 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'll also open up the phone lines for additional questions not covered by the e-mail Q&A or letter and the dial-in number is written within our investor letter. 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 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 10-K filed with the commission on February 1, 2013. A replay of this Q&A session will be available at the Netflix website after 6.00 p.m. Pacific time today.

Now, let's move into questions. As is our standard practice, we've organized the questions by topics as we've received them this afternoon. The first question is in regards to domestic streaming. How do you think about the risk in allowing domestic streaming margins to rise too high quickly? Example, enticing more competition or under investing in future growth?

David Wells - *Netflix Inc - CFO*

Hi, this is David Wells, the CFO. We think that with our growth, we're able to do both. We don't think that we're raising margins very quickly, so we are taking a measured approach. And, with the growth we're able to do both.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Do you believe the you can maintain domestic streaming marketing costs in 2013 flat with 2012?

Reed Hastings - *Netflix Inc - CEO*

We'll take that -- this is Reed here. We'll take that quarter by quarter, but as our reputation improves from the service improvements we're making and we get great PR around the original content, then that's what gives us a larger presence despite steady paid marketing spend.

Erin Kasenchak - *Netflix Inc - Director of IR*

Do you see a direct correlation between the time a consumer spends using Netflix daily or monthly and their propensity to churn?

David Wells - *Netflix Inc - CFO*

Yes, we do. We said this before, and it still holds, that the more a subscriber watches, the better they retain in the service.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. When you think about growing your domestic subscriber base, how do you prioritize one reaching first times streaming subscribers? Two, finding a way to bring back consumers who have tried the for the service before and left? Or three, reducing churn to maintain your current subscriber base? Have you seen any notable changes in these three groups over the past several months? If so, why?

Reed Hastings - *Netflix Inc - CEO*

Well, let's see. In the rejoin case, most of what we do is improving our service so that it works better for them. And so, someone who's rejoining wants to hear about the content's gotten better or the device space streaming is better or the iPhone interface is better, depending on the reason that they canceled.

In terms of -- you can't move a rejoin very much with paid marketing because they have a pretty firm idea of what Netflix is. You move someone in rejoin because you can change if you claim the benefit that the they didn't perceive before like those examples that I had. With new member marketing, they have a more hazy idea of what Netflix is and so paid advertising can have a bigger impact in changing their perception to be something that they're interested in trying for free.

And so, when we advertise we think of it mainly as this great service applying to new members. But, of course, there's a spillover benefit to existing members that are still on the service and to rejoins. But, the fundamental of it is to never-joins.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Another question as it relates to marketing, your marketing campaign has evolved pretty dramatically over the past year as we've illustrated. Could you discuss why you're taking brand marketing and commercials so much more seriously?

Reed Hastings - *Netflix Inc - CEO*

Well, I think we've always taken it seriously and our demographics have evolved. And so, our advertising evolves as we become more streaming instead of hybrid and as we get bigger. So, I think it's a natural outcome as well as just great execution.

Erin Kasenchak - *Netflix Inc - Director of IR*

How do you think about shared accounts? It grows your brand yet it is revenue lost. How do you think about the need or importance of cracking down on shared accounts?

Reed Hastings - *Netflix Inc - CEO*

It depends on what you mean by shared accounts. We usually like to think that a husband and wife can share an account and that that's perfectly appropriate and acceptable. If you mean, hey, I got my password from my boyfriend's uncle then that's not what we would consider appropriate. And so, we focus on serving the immediate family. We've got -- our standard plan has two simultaneous streams.

And, that serves the vast majority of families around the world quite well. There's a few times when the family is large that's two streams doesn't work and so we're now offering, or will be offering shortly, a four stream option for about a 50% uplift. But, again, as we said, we expect a fewer than 1% of our members to take that plan. So, the core focus is on the immediate family. And, we really don't think that there's much going on of the I'm going to share my password with a marginal acquaintance.

Erin Kasenchak - *Netflix Inc - Director of IR*

What do you see the realistic TAM for Netflix? If you look at other premium networks they tend to peak out at about 30 million subscribers. If you get to that point where your net adds start to slowdown would you put in place price increases, especially since HBO retails for $15 and you only charge $8?

Reed Hastings - *Netflix Inc - CEO*

Well, first, we started with streaming at $7.99 three years ago when we introduced the streaming plan. We've kept the same price for the last three years. We're very happy with that price. We've improved the content significantly, improved the devices, and we've kept the same price $7.99 and that's provided us a lot of growth. So, I don't see any changes in the near-term coming in that.

Second, in terms of the total available market, we've generally described it, as best we can, as two to three times that of HBO linear. HBO linear is at about 30 million. And, our best guess is that the market for a service like Netflix because it's less expensive than HBO, it's got more content, it's all on-demand, it's personalized, it's on multiple devices, is somewhere in the two to three times HBO, or 60 million to 90 million. And, we'll only know that with any confidence when we get there.

Erin Kasenchak - *Netflix Inc - Director of IR*

What was the biggest driver of domestic streaming subscriber upside in Q1? Higher gross additions or lower churn versus your internal projections?

David Wells - *Netflix Inc - CFO*

Well, we don't really talk about the individual. I would say that we've gone to great lengths to raise the content, the quality of the content on the site, and I'd say that was the biggest driver in Q1 overall. More people really engaged in the site and with the content.

Erin Kasenchak - *Netflix Inc - Director of IR*

Moving on to questions about content. Based on the greater than 4 billion streaming hours reported by Netflix in Q1 2013, we estimate the average Netflix scriber is streaming 87 minutes of content per day. However, when we analyze sand mine data related to overall bandwidth consumption, we have noticed a dramatic difference between the mean and median with the median only one-third of the mean. Is Netflix median monthly streaming dramatically skewed from the mean?

Reed Hastings - *Netflix Inc - CEO*

No, median typically is less than average because of the heavy users. But, it's not dramatic.

Erin Kasenchak - *Netflix Inc - Director of IR*

Have there been any notable changes in third-party content negotiations since you became more active with originals?

Reed Hastings - *Netflix Inc - CEO*

No. I would say the only thing that's noticeably changed in the last 12 months is Hulu and Amazon bidding more aggressively. And, that that's made the content owners much happier and it's made the prices, to us, higher than they would otherwise be.

Erin Kasenchak - *Netflix Inc - Director of IR*

How many users access Nickelodeon and MTV content monthly?

Reed Hastings - *Netflix Inc - CEO*

I'm not sure. We don't look at it that way of how many users. But, it's been part of our service for the last two or three years and, as we stated in the letter, we have some bids in on particular shows. And so, we'll see how that works out.

Erin Kasenchak - *Netflix Inc - Director of IR*

Also, on the Viacom relationship, as you move from a global licensing deal with Viacom to one covering specific titles can you provide some color on the magnitude of impact this could have on the money you spend licensing domestic content from Viacom?

Reed Hastings - *Netflix Inc - CEO*

I don't think you'll see any change. You're not going to see any blip in what we spend or in contribution margin, for example, in Q3.

Erin Kasenchak - *Netflix Inc - Director of IR*

Okay.

David Wells - *Netflix Inc - CFO*

I would say that the content -- our content acquisition is already factored in what may or may not happen and we've got things in the wings that we can add. So, you'll continue to see us invest in content.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Let's move onto questions about original. Why wouldn't we expect Arrested Development to drive significantly higher net additions in Q2? The guidance implies a rather modest sequential gain.

Reed Hastings - *Netflix Inc - CEO*

Well, if in Q1 we had seen, for example, the week before House of Cards launched and the week after a big spike, I think then we would be forecasting bigger numbers around particular titles like Arrested Development. But, what we've seen with House of Cards is a very nice impact but a gentle impact, not one that's an overnight impact.

And, Arrested Development's coming in in the end of May, and so it's going to be great for us. But, it's not a step function where on that day -- we've had no evidence and no history of it being a step function. So, we're comfortable with the projection being our median probability.

Erin Kasenchak - *Netflix Inc - Director of IR*

Releasing all episodes of House of Cards, Hemlock Grove, and soon to be released Arrested Development clearly puts the consumer first yet the social media buzz appears to die off very quickly. In contrast, when you look at TV series, especially HBO and Showtime, which it appears Netflix is trying to emulate, social media buzz benefits notably from the weekly release of a new episode. Why are you so confident in your all at once releasing strategy?

Reed Hastings - *Netflix Inc - CEO*

I would put the buzz on House of Cards and I think we're going to see that with Hemlock. As we mentioned in the letter, Hemlock viewing has been fantastic for us and as fantastic as House of Cards is, Hemlock is getting viewed by even more subscribers in its first couple days and opening weekend than House of Cards. So, we're feeling very good about our original strategy, including the release strategy, of being focused on all episodes at once.

Erin Kasenchak - *Netflix Inc - Director of IR*

Next, there are several questions about how to gauge the success of House of Cards. Would we share any metrics like what percentage of the base watched one or more episode? How viewership of House of Cards compared to other top shows on Netflix? And if not, how do we convince someone that it was a good investment?

Reed Hastings - *Netflix Inc - CEO*

Well, I think when you look at Netflix you get to invest in Netflix not a particular show. So, what's an investor cares about it is that Netflix is a good investment as opposed to say, House of Cards. And then, individual marketing programs, individual shows, individual regions are really what we have to do is management in terms of making good trade-offs to make Netflix more valuable overall.

And, on that basis, we're feeling very excited about what's happened with House of Cards and with Hemlock, what's coming with Arrested Development and Orange is the New Black. And, I think over this year, with a continuing rollout of these original shows, you're going to see a very nice redefinition and broadening of what Netflix is to our members.

But, it's something we'll take a step at a time. As we mentioned, our total P&L spending on originals is still single digits, it will still be single digits next year. So, it's growing, but it's still the relatively modest part of our total content spend.

Erin Kasenchak - *Netflix Inc - Director of IR*

House of Cards is available for pre-order on Amazon.com. Can you explain where your rights to the show stand in relation to sales of the show on DVD and Blu-Ray? Do you receive a cut for each one sold? And, if so, how much?

Reed Hastings - *Netflix Inc - CEO*

We're not going to comment on the specifics. Each deal for original is a little bit different. MRC developed House of Cards and we were the first window licenser in certain territories and then they have the other rights with certain hold backs. And so, occasionally you'll see something where the DVD's out earlier than you might otherwise expect.

Erin Kasenchak - *Netflix Inc - Director of IR*

With House of Cards you promoted the show in a very visible way when people logged into their Netflix account. Should we expect ongoing Hemlock Grove promotion in the same way?

Reed Hastings - *Netflix Inc - CEO*

Only if your demographic profile and what we've been watching includes things like Vampire Diaries and such shows. Because what we do is match it to the person and to their viewing history or if someone in your household is watching that. We try to be very good about matching the right promotion to the right person.

Erin Kasenchak - *Netflix Inc - Director of IR*

Looking over the next few years how many original series do you believe you would be willing or able to produce?

Reed Hastings - *Netflix Inc - CEO*

Well, we'll start this year with just our six or seven seasons then we'll take that up a little bit next year. And then, we'll see as we go in terms of what we learn, what experience, so there's no set number we're trying to target. It will depend upon the results that we see.

Erin Kasenchak - *Netflix Inc - Director of IR*

How do your originals perform in international regions versus the US? We've only got three so far, Lillehammer, House of Cards, and Hemlock. And, I would say each one is unique in its territory. So, we do program for these being good internationally. And, some of them have been really big hits. And, you may have noticed that with Hemlock, we did one of the first premieres for it, premiere parties, in Mexico City. So, that's an indication that we really focus on the global attractiveness of the content. Regarding the expensing of original content such as House of Cards, over how many months, quarters, years does Netflix anticipate amortizing the cost of the content? That is, what is the expected life of original content? Also, does original content generally carry a long will longer useful life relative to other purchased content?

David Wells - *Netflix Inc - CFO*

No, it doesn't generally carry from amortization period longer than other content. We could discuss whether or not the actual use useful life of that content might be longer but we don't have any history so we're a little bit conservative at this point. And, the typical license period, or the typical amortization period is over -- is straight-lined over the license period.

Erin Kasenchak - *Netflix Inc - Director of IR*

Looking of the cost to produce very high quality content like House of Cards do you think this cost will increase decrease or stay about the same over time?

Reed Hastings - *Netflix Inc - CEO*

I'm not sure. It hasn't moved dramatically despite digital filmmaking. And, if anything, the scale of distribution drives both movie production costs per hour and television costs per hour up because the value of great product with a large distribution channel has increased. And, that effect has overwhelmed what some people thought would be bringing down the costs a lot of production through digital filmmaking techniques.

Erin Kasenchak - *Netflix Inc - Director of IR*

With the success of House of Cards and you're growing stable of originals has movies become a less strategic asset to Netflix?

Reed Hastings - *Netflix Inc - CEO*

I sure hope so given -- I sure hope not given how much we've signed up to spend with Disney. And, we very much are investors in the movie franchise both in the US and around the world. And, big believers in the role of movies on our service.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Let's turn to questions on competition. Amazon has clearly bid up some popular titles. Are you seeing them be highly competitive in most of your negotiations? Or are they just stepping up for select content?

Reed Hastings - *Netflix Inc - CEO*

It varies quite a bit by region and by type of content. But, certainly, all the sellers of content want to have many active bidders. So, they are approaching everybody, Red Box, Hulu, the cable networks to try to get bids to be competitive.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great, let's turn to questions on International. Do you have a set reinvestment plan for international growth? Meaning, is there a percentage of cash flow generated domestically that you will invest annually into international? Do you envision continuing to add new overseas markets ahead of getting the entire international business to profitability? Meaning, should we expect overall international losses to continue for years to come in aggregate?

David Wells - *Netflix Inc - CFO*

Well, we've said in the past that what's been our approach with international is that we'll take a measured approach dated by global profitability and our overall confidence in the growth of the existing markets that we have today and that hasn't changed. So, I think it is safe to say that you'll see another couple of years of international losses as those markets mature and grow towards profitability and as we launch additional markets. And, as for going forward, we'll continue to take that measured approach. We'll have to gain confidence in the new markets as we address new opportunities and go from there.

Erin Kasenchak - *Netflix Inc - Director of IR*

As sort of a follow-up, any update on the profitability timeline for individual international markets like Latin America or UK specifically?

David Wells - *Netflix Inc - CFO*

We don't give specifics. We've given some directions in the past in terms of those markets being competitive and taking longer than Canada. And, I'd say that's still accurate.

Reed Hastings - *Netflix Inc - CEO*

And, we've said specifically that all of the markets are growing and that we're profitable in Canada.

Erin Kasenchak - *Netflix Inc - Director of IR*

Would you consider shutting down such higher loss territories like Latin America?

David Wells - *Netflix Inc - CFO*

Well, we're still making very good progress. Again, we've said that we're growing and we're reducing losses in those markets. We're not losing out to any competitors. And so, if we get into a situation where we thought we were losing to competition, we'd have to consider that. But, that's not where we see ourselves today.

Reed Hastings - *Netflix Inc - CEO*

The simple answer is no, we wouldn't.

Erin Kasenchak - *Netflix Inc - Director of IR*

Should we model the initial spend for the European launch to be comparable to other International long said launches? Will this be Q3 or Q4?

Reed Hastings - *Netflix Inc - CEO*

We've said second-half, we'll stick with that articulation. And sure, you could model it about like other launches.

Erin Kasenchak - *Netflix Inc - Director of IR*

Turning to a few questions on DVD, do you believe that you have less visibility into the subscriber and revenue elements of DVD business? Is that a factor in reducing the guidance disclosure?

David Wells - *Netflix Inc - CFO*

No, we don't. In fact, we probably have more visibility into that then we did, say, a year to 18 months ago. The reason we dropped the guidance was because profit is what matters and that really is the only thing that matters at this point. We'll continue to report subscribers and revenue, but we'll only give guidance on the profit.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Have you've been able to relatively maintain -- you have been able to relatively maintain strong DVD contribution margins even with declining subscriber levels. At what level of DVD subs would that ability to leverage fixed costs breakdown and lead to a meaningful step down in overall profit margins?

David Wells - *Netflix Inc - CFO*

Well, we took the DVD business profitable at around 1 million subscribers. And, given that we've got a large investment in equipment that we won't have to continue to invest in our content library, in our DVD content library, we feel pretty good about our ability to maintain those margins going forward.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Let's turn to some questions on product improvements. ISPs appear increasingly open to the idea of offering promotions incorporating Netflix as a benefit to their own subscribers for paying up for premium service higher speed tiers. How do you think about this opportunity?

Reed Hastings - *Netflix Inc - CEO*

Well, I think the ISP business is turning out to be extremely profitable because ISPs don't have content costs. And, if they can get their customers to purchase higher bandwidth packages, that's almost pure additional margin for the ISP. And, one of the major reasons that a customer might do a higher bandwidth package is to use video from us, from Hulu, from Amazon, and others.

And so, the more that our network integration is highly effective, that they're integrated with open connect, then the more their customers will actually get the benefit of a faster last mile. So, there's a nice synergy there of us together providing a better and better experience for their end-users.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. A question on social. While you succeeded in winning a change in the VPPA there does not appear to be a meaningful amount of Netflix subscribers choosing to share their streaming activity within their friends on Facebook. Do you think consumers simply are not interested in being that open with their social network?

Reed Hastings - *Netflix Inc - CEO*

I think it will evolve over time. The core focus right now is not so much sharing on Facebook the viewing history, in fact that's not the default. The default is that it's shared within the Netflix interface. So, if you give the permissions, the default permissions, you and your friends share within the Netflix user interface what your friends are viewing and get ideas but not in the Facebook ticker and feed.

Erin Kasenchak - *Netflix Inc - Director of IR*

How does the profiles feature work for households with a Netflix subscription and what was the early response from the testing?

Reed Hastings - *Netflix Inc - CEO*

It's been positive. The key use case is between kids and parents. Right now, parents will say that the experience is suboptimal because the kid's viewing is all through their profile. And, the kids similarly don't necessarily want to see what their parents are viewing. So, that's the biggest use case, so it will really be targeted at families.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Let's look at a few questions on financials. Could the company please quantify its off balance sheet content liabilities? Specifically interested in both the total amount of obligations outstanding as well as the amount currently outstanding that is not on the balance sheet.

David Wells - *Netflix Inc - CFO*

Sure. I'll answer this in total, too, because that's usually how we get this question. We had $5.6 billion liability -- or $5.6 billion in commitments as of the end of December. That moved to $5.7 billion in commitments as of the end of March. $2.4 billion being part of liabilities on the balance sheet and $3.3 billion not on the balance sheet.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. Do you believe the company can fund its liabilities without an additional debt raise or would you consider raising capital given the low rate environment?

David Wells - *Netflix Inc - CFO*

We just did raise capital, so yes, we would consider it. And, I would say that we're fine on capital at this point.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. You had anticipated that free cash flow in the quarter would be more negative than the prior quarter and it ended up more favorable than the prior quarter. You acquired less than $600 million of streaming content this quarter. Less than your quarterly run rate last year despite the payment for House of Cards. Were any content acquisitions deferred to the June quarter? Is this a good run rate for content acquisition or was this a low quarter?

David Wells - *Netflix Inc - CFO*

So, no content payments were deferred. I would say that we anticipated a bunch of small items stacking on each other in the first quarter that didn't happen. So, we'll be less lumpy than we previously anticipated. And then, the second part of that question was?

Erin Kasenchak - *Netflix Inc - Director of IR*

Is this a good run rate for content acquisition?

David Wells - *Netflix Inc - CFO*

I'm not sure how to answer a good run rate on content acquisition. I would say that we continue to expand our content. And, you'll see that expansion has declined over the last year and two years. So, the rate of expansion has started to slow but we'll continue to invest in content.

Erin Kasenchak - *Netflix Inc - Director of IR*

What was your effective Q1 tax rate? What's the tax rate that we should use for the second quarter and the balance of the year?

David Wells - *Netflix Inc - CFO*

Balance of the year should be between 34% and 35%. We had a very strange tax rate in the first quarter because of the retroactive reinstatement of the federal R&D tax credit. So, I think it was over 100% in terms of the strange rate. But, that will flip back to a normal rate going forward.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. At this time I'd like to turn the call over to the operator and begin taking questions from the phone.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Youssef Squali, Cantor Fitzgerald.

Youssef Squali - *Cantor Fitzgerald - Analyst*

Okay, thank you, very much. Just a couple questions, please. You guys spent a little more on DVD content this quarter than we were expecting. And, you also lost fewer DVD subscribers than we thought. So, was there a correlation between the two? I'm assuming there was. But, was that something that you guys are now baking into your business going forward? Second, can you expand on the profile function -- profiles function you guys spoke about in the letter? When does that launch and what efforts would -- what effects would you like to see from it? Thanks.

Reed Hastings - *Netflix Inc - CEO*

Youssef, it's Reed. I'll hit the profiles. It will be sometime this year. And, if it's not, it's not going to affect the financials. It's example of one more product feature that's useful, but there's nothing -- going to be nothing material to affect the business about it of itself.

David Wells - *Netflix Inc - CFO*

And Youssef, this is David. On your DVD content question I wouldn't draw a direct correlation. The first quarter is always the high release quarter for new releases. And, typically, it depends on the release slates for the studios in terms of what they put out. And we set those amounts well ahead of the quarter. And so, I wouldn't draw a direct correlation. I would say that, in general, we were pleased as well that DVD subscribers declined at a slower rate than we anticipated. And we continue to work hard to make sure that those folks continue to choose physical have a very good service.

Youssef Squali - *Cantor Fitzgerald - Analyst*

Thanks, a lot.

Erin Kasenchak - *Netflix Inc - Director of IR*

Next question?

Operator

Carlos Kirjner, Sanford Bernstein.

Carlos Kirjner - *Sanford C. Bernstein & Co. - Analyst*

Thank you. Have you deployed Open Connect to major domestic ISPs such as Comcast, Time Warner Cable, Charter? And, if not, why do you think that's the case? And, how do you square that with your view that Netflix is good for them because it helps them differentiate their offer? Thank you.

Reed Hastings - *Netflix Inc - CEO*

Carlos, I'm not going to comment on the specific deals but we're making progress with ISPs. We started mostly in Europe first because we were just ramping, so that helped with the capacity and we could handle the capacity. And, we've got the majority, or the vast majority, of Europe traffic is now in Open Connect and a growing percentage of that traffic is in the United States. We certainly think that over the next year or two we'll be able to work with all the major ISPs to get the benefits to both of us on Open Connect.

Carlos Kirjner - *Sanford C. Bernstein & Co. - Analyst*

Thank you.

Operator

Mark Mahaney, RBC.

Mark Mahaney - *RBC Capital Markets - Analyst*

On the new customers, the domestic streaming customers, is there anything you can tell about their usage patterns versus customers you've brought in in the past? Do they seem to be consuming content similarly to similar cohorts in the past? And, in terms of international marketing costs, is there a way to strip out the new country launch costs from the other marketing costs once, if you take those out, is it that international marketing costs are a steady ramp? Or is there something that suggests that they could flatline or is that way too early in each of those country's experience for that to happen? Thank you.

Reed Hastings - *Netflix Inc - CEO*

Mark, on the domestic side, the new members are performing consistent with the historical trends, which as we've steadily been able to increase viewing as the content and the product improves. And so, P1s today are a little better in usage than P1s a year ago, that kind of thing. And then, second on the international marketing, yes, there's a launch marketing and then a run rate marketing just as you would expect. But, since we've got -- and you'll see that a little bit when we have launch quarters, you'll see the marketing be larger than you might otherwise have thought.

David Wells - *Netflix Inc - CFO*

It's a little too early to tell if that run rate marketing is going to go up, down, or flat. I would say flat is a safe assumption at this point.

Operator

Scott Devitt, Morgan Stanley.

Scott Devitt - *Morgan Stanley - Analyst*

Reed, you talked in the shareholder letter about a decline in your willingness to pay for non-exclusive bulk deals. And, now you have an increasingly diverse content portfolio between TV, movie, kids, and originals. And, your sub base is much larger than competitors so theoretically, you would think that you would have the ability to amortize the content that you spent over a larger base of subs. You mentioned earlier in the call that while it's not been the case yet, that you've been able to get favorable negotiations based on this diversity of content now. I was just wondering if you could talk a little bit about the future to the extent that that could change over time?

And then, secondly, on and associated topic, Ted has been quoted recently in the media discussing expanding the original portfolio to levels that is north of 20 per year, which is quite a bit higher than where you are now. I was just wondering if you could clarify that comment to the extent you think this 20 plus is a reasonable level? And, if so, what type of timeframe of getting there? Thanks.

Reed Hastings - *Netflix Inc - CEO*

Let's see. Starting on the second part, it all depends on the timeframe. So, in the next two years, it's modestly increased. If that were wildly successful for us as the first three shows have been, we could continue to expand to 20 or north but that would be dependent on all of the -- what happens the rest of this year. What we don't want to do is on the back of three shows, one of which has only been out for four days, suddenly take our commitments up to that 20 plus level. So, that's in the longer-term and I think it's appropriately ambitious.

In terms of the first question, I think we're focused on moving towards more and more exclusive content which reinforces a reason to join Netflix, a reason to subscribe. To the degree the content is not exclusive and it's on cable and on other services, then it might be pleasant to watch on Netflix but it's not really a reinforcer of why stay with Netflix or a reinforcer of what you would lose if you were not on Netflix. And so, we've been, I think, for the last two or three years evolving towards more and more exclusivity in that content.

Scott Devitt - *Morgan Stanley - Analyst*

Thank you.

Operator

Richard Greenfield, BTIG.

Richard Greenfield - *BTIG - Analyst*

Could you give us more info on why the Open Connect initiative is so positive for Netflix? And then, tied to that, if cable operators, they're showing you within their actual commercials now and marketing you in their mailers, is there a way that they could basically promote Netflix or give away Netflix or pass through cost of Netflix the way they do and give like a six or 12 months of HBO or Showtime, how could that work? And is that something we might see in the next year?

Reed Hastings - *Netflix Inc - CEO*

Open Connect is one of our investments to improve the Netflix member experience. Long-form content has some unique aspects that you can tailor at low costs on a CDN if you're not also serving short-form content like the general commercial CDNs are optimized for. But, in the scheme of things it's pretty modest relative to our P&L. It's not particularly significant. In terms of the second question, which is commercial integration with ISPs and broadband, we haven't seen a lot that is particularly effective.

We've seen some things where some companies will purchase gift certificates for Netflix and then advertise that if a person signs up for a service or buys the device, they also get three or six months of Netflix which is a gift certificate that they bought. And, some of those are working quite well. But, I doubt that you'll see anything in the way that you typically would have seen for HBO or Showtime marketing with cable where you get those big free periods in exchange for signing up. The business model that we have now works very well for us. And, since it's working very well, we're more likely just to focus on executing it extremely well rather than making it, say, more complicated with those types of interactions.

Richard Greenfield - *BTIG - Analyst*

Thank you.

Operator

Heath Terry, Goldman Sachs.

Heath Terry - *Goldman Sachs - Analyst*

I was wondering if you could give us a sense, even if it's just high level, of what share of the current subscriber base you feel like will be impacted or interested in the multi-tier subscriber, or multi-stream subscription plans, in order to -- or would need those in order to maintain their current level of usage?

Reed Hastings - *Netflix Inc - CEO*

Do you mean the four out $11.99 plan, Heath?

THOMSON REUTERS

Heath Terry - *Goldman Sachs - Analyst*

Right, right.

Reed Hastings - *Netflix Inc - CEO*

Less than 1% of our members.

Heath Terry - *Goldman Sachs - Analyst*

Okay, great. Thank you.

Operator

Mike Olson, Piper Jaffray.

Mike Olson - *Piper Jaffray & Co. - Analyst*

It looks like originals are having success out of the gates and as your library of exclusive content grows, you could argue that subs will perceive higher value in the subscription. So, under that assumption, and as we get farther from the PR issues of a couple of years ago, will you look more seriously at tweaking up pricing?

Reed Hastings - *Netflix Inc - CEO*

I think we were pretty clear in our letter about that.

David Wells - *Netflix Inc - CFO*

So, we're pretty happy with the current $7.99 price.

Mike Olson - *Piper Jaffray & Co. - Analyst*

Okay. Thanks.

Operator

John Blackledge, Cowen and Company.

John Blackledge - *Cowen and Company - Analyst*

Two questions. If you could provide an update on the brand, is it recovering more quickly than you anticipated since the brand hit following the split of the streaming and DVD service in 2011? And then, secondly, the 2Q '13 US streaming net add guidance, at the midpoint, is a bit above 2Q '12 net adds. So, that appears moderately more positive than commentary from the 4Q '12 letter which suggested 2Q ' 13 net adds would be below 2Q '12 levels. So, was original programming driving moderately better guidance or are there other factors involved? Thanks.

THOMSON REUTERS

David Wells - *Netflix Inc - CFO*

John, I'll take the second part of that question which is our 2Q net adds guidance. I would say that ordinarily we would expect because of seasonality to have a lower Q2 than prior year. But we've seen a lot of improvements, we talked about that in the letter, we have seen a lot of improvement in our product and our content and the interface and in the brand recovery. And, I think those are carrying through, so we're anticipating being slightly up year-over-year. And then, I'll let Reed comment as to the brand recovery as to whether that's ahead, on track or about as expected.

John Blackledge - *Cowen and Company - Analyst*

And on the guidance, we have Arrested Development the end of May, which will be an absolutely spectacular phenomenon where we've got an established brand that's a cult favorite. It's been off the air for seven years, and Mitch Hurwitz and the cast have done just a remarkable job. So, we're unlikely to have that again in Q2 a year from now. And I think we'll return to the seasonal pattern where Q2 is less than prior year. In terms of brand recovery, it's been just as we had hoped and thought and expected, which is over three years where you get the bulk of that in the first part, and we're making steady progress. And we'll continue to work hard to make steady progress going forward. Great. Thank you.

Operator

Doug Anmuth, JPMorgan.

Doug Anmuth - *JPMorgan - Analyst*

Just wanted to ask two things. First, how do you compare Netflix's ability to curate and influence original content relative to other pay-TV networks? How important is that to producers when you're talking to them about originals? And do you think that's an area where you would expect Netflix to bulk up in order to work more closely with creators on content? Then, secondly, just a question on mobile, any color on the percentage of usage coming from tablets and smartphones? And do you think there's any chance here going forward that we could see mobile smooth out some of the seasonality that you typically see during the summer months? Thanks.

Reed Hastings - *Netflix Inc - CEO*

Doug, in terms of mobile and tablet it's continuing to grow, whether it smoothes out seasonality, I'm not sure. Most of the quote, mobile use is on Wi-Fi. It's home use rather than over the cellular networks which have the fairly low data caps. And then, what was the first part?

David Wells - *Netflix Inc - CFO*

Curating and how we --.

Reed Hastings - *Netflix Inc - CEO*

How we work well, yes with producers. We're getting, I think, more sophisticated in terms of working with producers and the creative community. I think we've got a great start in what we've done obviously. And we'll continue to learn as we do more. As we bring great success to the creators, then certainly that increases our reputation in the creative community.

Erin Kasenchak - *Netflix Inc - Director of IR*

Great. That's all the time we have for questions today. Reed, would you like to make some closing remarks?

Reed Hastings - *Netflix Inc - CEO*

Thank you all for your support. I hope everyone gets a chance to see Hemlock Grove.

Erin Kasenchak - *Netflix Inc - Director of IR*

Thanks.

Operator

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