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# EDITED TRANSCRIPT

NFLX - Q1 2016 Netflix Inc Earnings Call

EVENT DATE/TIME: APRIL 18, 2016 / 9:00PM GMT



## CORPORATE PARTICIPANTS

**David Wells** *Netflix Inc - CFO*

**Reed Hastings** *Netflix Inc - CEO*

**Ted Sarandos** *Netflix Inc - Chief Content Officer*

## CONFERENCE CALL PARTICIPANTS

**Ben Swinburne** *Morgan Stanley - Analyst*

**Peter Kafka** *Re/code - Analyst*

## PRESENTATION

**David Wells** - *Netflix Inc - CFO*

Welcome to the Netflix Q1 2016 earnings call. I'm David Wells, CFO. I'm joined today by Reed Hastings, CEO, and Ted Sarandos, Chief Content Officer.

Interviewing us today will once again be Ben Swinburne from Morgan Stanley and Peter Kafka from Re/code. Just a warning before we begin that we will be making forward-looking statements. Actual results may vary.

I think, Ben, you have the first question, so over to you.

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## QUESTIONS AND ANSWERS

**Ben Swinburne** - *Morgan Stanley - Analyst*

Thank you. Reed, maybe you can start out by just reflecting on the quarterly results you guys just delivered relative to your expectations. And maybe you could start out, in the new markets you launched at the beginning of the year, and how those performed relative to your expectations.

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**Reed Hastings** - *Netflix Inc - CEO*

Sure. We were incredibly excited to grow to over 81 million subscribers. It's an enormous quarter for us that way. Some of it was from our expansion around the world. It's 130 countries, so there's quite a bit of variety.

And remember that most of those countries we haven't yet seen the full potential of because we're only in English and only with international credit cards. So over the next couple years as we further localize, we'll be able to see more opportunity. But by going so broad, we've increased our rate of learning and so we're really excited about the approach and looking forward to the rest of the year.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

And how did you feel the US markets behaved this quarter versus your expectations? You had noted in the letter a lot of strength from the originals that came in ahead of expectations, I'm guessing that's on gross connects. But how did the originals perform even relative to what I'm sure were your fairly bullish expectations in the US market?

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**Reed Hastings** - *Netflix Inc - CEO*

In the US market, we did about 2.25 million net adds which is nearly identical not only to last year but to the year before. So what you see is this continued growth, and we're thrilled to keep that growth steady at between 5 million and 6 million net additions, and the content just keeps improving, and that keeps the word of mouth growing. So we're very excited about that formula and what we saw in Q1.

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**Peter Kafka** - *Re/code - Analyst*

Reed, you guys have been watching a Amazon for a long time. You compete with them at least on content for quite some time. Four years ago, you predicted they'd come out with a standalone service priced under yours. They announced that yesterday.

What's your view of them now? In particular, with the a announcement they made yesterday, do you think they're trying to compete head to head with you for subscriber dollars, or are they trying to underscore the value of Prime overall?

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**Reed Hastings** - *Netflix Inc - CEO*

Hulu is doing some great work. Amazon is, HBO, Showtime. There are so many competitors, and everyone is working hard to build the best content. And so we're seeing growth in the overall Internet TV market. Of course, that's displacing linear TV, and it's natural that everybody is coming in as they realize that the future is internet TV.

In terms of our shows, we're very excited about what we're doing. Not only are we expanding the number of original series we're doing, but we're also expanding into original movies. So again, this is all part of the natural evolution from linear TV to internet TV.

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**Peter Kafka** - *Re/code - Analyst*

Amazon has been talking with programmers for a while about adding linear channels. So you're looking at a scenario where they might have an offering that's similar to yours for the OnDemand stuff and the mix originals and older movies and TV shows, plus current content live. What does that look like to you in terms of the prospects of competing against that head to head?

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**Reed Hastings** - *Netflix Inc - CEO*

We're very focused on global competition. Obviously, around the world it's very fast growing for us. We're coming towards 50/50 international, domestic revenue. And so we're focused on content that we can have around the world, which is why we're investing in original movies, original series, so that we can have that content. And also producing around the world like our French series Marseilles, or Spanish in Narcos, and that's very different from carrying other people's single nation networks. So that's just a very different business, it's not one we focus on a lot. We know what we want to be, which is a great global producer and distributor of content and other people will do other things. And that's fine, they may be very successful.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Let me throw a question out for David and/or Ted about thinking about the second-quarter guidance internationally. There's a lot to chew on there. The number you laid out is probably below where most people were expecting.

I'm wondering if you could talk, David, about how you thought through putting the second-quarter guide together around seasonality, some of the comp issues you talked about in the letter, and whether we're seeing more -- a more earlier than expected level of seasonality in some of these markets that are still one or two years old?

And, Ted, there's a narrative out of Europe in particular that the incumbents are teaming up against you from a consent perspective, and you've got a lot of stuff coming down the pike on originals. So if you can talk about your relationship with suppliers overseas, since that's probably an area people have spent less time thinking through.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

I'll let David kick it off there or actually go first.

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**David Wells** - *Netflix Inc - CFO*

So, Ben, in terms of thinking about the guide. Just a reminder of that we put in the letter that absent the strong performance that we saw last year from a very recently launched Australia New Zealand market, our guide would have been up. So I think you haven't yet seen a normalized pattern of growth from us in terms of a year-on-year growth expectation across our international markets, because we've been layering on new markets as we go.

So I think from our perspective, we were super happy with the results of Q1. And we wanted in Q2 that to continue, and it is. But we're mindful of the fact that we've got these large blooms of launches last year and then in Q1 this year with the rest of world markets, the Netflix global launch, that are going to continue forward because they're addressing pent-up demand.

So for us, we're focused on continued growth in those markets and that's what we're seeing. And we're focused on continued improvement from an economic sense of reducing those losses. This year, you're seeing us continue to invest but the US is growing, so overall, operating profit is improving as we go and into next year.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

Can I just say, the reaction from the broadcasters and across Europe is not different than it's been anywhere else. There's always uncertainty when we come to the new market, what role we're going to play, how complementary we're going to be versus competitive. I think everyone likes to weigh all their options in terms of their competitive strength.

We're buying a lot of pan European rights as part of our global acquisitions, which I think probably makes them a bit nervous too while they're trying to figure out what their next moves will be. But again, I don't think it's that unusual. Even here in the US where three of our largest suppliers teamed up to create Hulu with probably much of the same motivation.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

And just as a follow up, there's, I don't think, been any mention of VPN changes in the letter, but that obviously has happened. Is that impacting at all the second-quarter guidance at all?

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**Reed Hastings** - *Netflix Inc - CEO*

No, all that change was in the first quarter. It's a very small but quite vocal minority. So it's really inconsequential to us as you could see in the Q1 results.



**David Wells** - *Netflix Inc - CFO*

The only thing I'd add to that, Ben, is we were able to grow. In the first quarter, we had a very strong US growth. At the same time, we had a very robust Netflix global launch. So I think it validates the fact that we're seeing new demand for Netflix in those markets.

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**Peter Kafka** - *Re/code - Analyst*

Sure. This is for Reed. You keep getting asked this, but I want to keep asking because the question keeps coming up. Any interest in live sports in any capacity?

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**Reed Hastings** - *Netflix Inc - CEO*

Any interest in what?

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**Peter Kafka** - *Re/code - Analyst*

Live sports.

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**Reed Hastings** - *Netflix Inc - CEO*

Live sports. Ted, I'll let you handle that question. It worked so well for us last time.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

There's no interest in live sports currently.

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**Peter Kafka** - *Re/code - Analyst*

Currently. And what about live in general? There's a lot of interest, Twitter, YouTube, Facebook in particular, and the idea of broadcasting live video over the internet.

You guys have tweaked your model a little bit or will be tweaking a bit with Chelsea Handler where you're going to move away from the dumping out all the stuff at one go and staggering it. So if you don't plan to do live now, why not consider it down the pike?

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**Reed Hastings** - *Netflix Inc - CEO*

So just to correct you, we have never dumped anything. We have given it a proper platform with all of the great content that it deserves.

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**Peter Kafka** - *Re/code - Analyst*

Full release.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

So Chelsea is near live, in that we're going to be putting it up to our subscribers just a couple hours after it's recorded live in front of an audience. There's not a technological reason we wouldn't want to go to live.



But you should think about our brand proposition as very much about OnDemand. So to the extent that watching OnDemand is better than watching live would bring a ton of value to it. And other people doing live, I think it's great. It's about the further expansion of internet television to include live. We don't have to do everything to be part of that expansion.

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**Reed Hastings** - *Netflix Inc - CEO*

And rather than invest in things like live sports, we're investing in things like The Crown, which is just an epic production and maybe you could talk a little bit about that, Ted.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

It's being shot right now in the UK. We've previewed some footage of it to the European press last week. They just loved it. It's a massive cast, a massive production that will tell the life of Queen Elizabeth starring Claire Foy as the Queen, and will follow her life through her relationships with the Prime Ministers all the way through to current times. So it's those kind of things that we think are massively global that we could produce on a larger scale than anybody else that we really think we can win the day on.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

David, coming back to the second-quarter guidance again, but on the US market. Why did you decide to delay or spread the ungrandfathering through the remainder of the year?

You mentioned you don't expect much of an impact, but you've decided to spread it out. Maybe you could walk us through what you've learned in your testing so far and the thought process around that.

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**David Wells** - *Netflix Inc - CFO*

I think we've always been a testing Company. So perhaps there should have been an expectation that this would be a gradual thing in terms of layering that out. We've got a number of markets that are coming off on grandfathering, not just the US, and some of those are timed three to four months as we go.

So I think it's just about messaging it. It was important to us to make sure that subscribers knew that this was happening and to put it in front of them and that's what we're going to do, and we want to do that -- do right by the consumer and do right by Netflix as we go. So I think we're just taking our time to do that.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

And, Ted, what are you seeing on terms of the efficiency of your spend as you continue to build on originals? And I'm curious, you've had more data points around film results, have more coming up. How the are the films performing relative to your expectations, and relative maybe to the spending on TV series?

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

The efficiencies are a little hard to match, because you've got a couple hours of viewing versus 10 to 13 hours of viewing on a series. But relative to how we license other movies, we've been pretty happy with the direction that it's going.



Remember, we have a few films under our belt. What I'm really looking at is how broadly people engage with them, how do they play around the world. All of those data points have been really positive. And as we keep going, I think that that content can be as efficient as a series relative to other films. We're still learning as we go though.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Thank you.

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**Peter Kafka** - *Re/code - Analyst*

Can you guys talk about your M&A strategy? Are you looking at Paramount which may be partly for sale; what about Starz which is unofficially for sale? If you don't want to comment on those in particular, what are you thinking about as you consider large acquisitions?

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**Reed Hastings** - *Netflix Inc - CEO*

It's been 15 years we've been public and 20 existing, and we've done no M&A. So I think that probably speaks for itself.

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**Peter Kafka** - *Re/code - Analyst*

And as you guys push into the studio film business, making your own movies, does it make sense to at least do a smaller acquisition that would help you get some of those competencies in house?

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

Peter, what you're seeing not just on the films but also on several of our series where Netflix is increasingly the studio and the network on those shows, so we are building that efficiency in house. The Ranch that just premiered a few weeks ago is a Netflix produced show, and we'll be doing a lot more of those coming out. We're building it versus buying it.

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**Reed Hastings** - *Netflix Inc - CEO*

We'll just hire the people that we want and build it. That could in principal be a constraint on our rate of growth, but Ted's been able to attract an incredible team in LA. When you look at the growth in our originals, you can see that we can deliver on that on this organic hiring basis which of course is much stronger for the long term than if you tried to juice it with M&A.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Reed, can you talk a little about how investors and shareholders should look at various opportunities internationally? For example, Brazil's a market maybe at first blush wouldn't appear to be right for Netflix given low pay TV penetration, lower household income, lower broadband speeds, and yet you've described that as a rocket ship. You've done really well there.

And yet, maybe other more developed markets in Europe have been slower. What are the characteristics and things that are outside Netflix' control that drive success, and what are the things that you're doing that you maybe didn't do a year ago to make sure you capture the opportunity?



**Reed Hastings** - *Netflix Inc - CEO*

One of the major things I think is eCommerce and payment systems to the degree that there's a convenient way to pay for airline tickets, for example, online. That's really helpful. But we're continuing to work with all the different ISPs, phone billing solutions, other things, and will grow as the payment infrastructure or the eCommerce infrastructure grows.

So when you think about it in the long term, everybody around the world is going to be watching internet video. And we want to be well positioned so as all of these countries evolve towards internet video that we grow with them. In some cases that will be 10 years, 15 years, in other cases it will be in the next 2 or 3 years. But it's a long-term investment, and country by country it's worked out extremely well for us.

So that's why we're so invested in international expansion. We're very confident that in the long term, everybody is going to be watching TV shows and movies over the internet and we hope to be one of the leading brands for that around the world.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

And let me just ask you -- go ahead, David.

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**David Wells** - *Netflix Inc - CFO*

The only thing I would at to that too and I think Reed would say is you can't anticipate everything. And I think five years ago when we were first launching the markets we thought maybe we could anticipate most things, but every time we've launched there's been one or two things that we haven't anticipated.

What we have gotten good at as a Company is fast learning and fast improvement. And so I think that gives us some confidence as well that as things come up, we'll be able to address them quickly.

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**Reed Hastings** - *Netflix Inc - CEO*

And remember when you look at Facebook and YouTube, which are ad supported, but viewing and consumption is generally 80% international, 20% domestic. We've got a lot of international growth to go before we can aspire to that point.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Let me just pick up on a question Peter asked earlier that talks about where Amazon is taking the bundle, and take it from the perspective of the incumbent MVPDs. You saw, I'm sure, Reed, that Dish built another Sling or is building another Sling offer, a low price point, IP delivered bundle of networks. DirecTV is going to have three, cheaper OTT launches later this year.

You're starting to see these things proliferate more. Does that change your competitive position as you think about this big pricing umbrella getting smaller over the next year plus and becoming more IP?

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**Reed Hastings** - *Netflix Inc - CEO*

No, those are all single nation solutions, and we're really focused on global content and expanding globally. So I don't see really that much nexus between them.

Again, as we said in the letter, when you think about your own experience of what do you do some night if you're not watching Netflix? Once in a while it's cable television, once in a while it's video gaming, it's browsing Facebook, killing time on the web generally. There's so much out there.

So the only inhibitor in our growth is how great is our service. Can we make it so there's never buffering so it always starts up instantly. So the recommendations are incredible, and that the content is exciting. And if we can do all that, we'll continue to grow globally even though HBO or Dish or others are also growing. So their growth doesn't take away from us.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Thank you.

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**Peter Kafka** - *Re/code - Analyst*

Reed, can you explain just for the record why you guys went ahead and reduced the quality of streams on certain wireless carriers, and how that's different than the complaints you lodged against people like Comcast in the last couple years?

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**Reed Hastings** - *Netflix Inc - CEO*

Sure. Mobile generally has small data caps and very expensive per gigabyte charges like \$10 to \$20 per gigabyte supplemental. So we've wanted to save data for our users by using very tight and small encodes, especially when it's been watched on a four or five inch screen. And what we'll be adding going forward is an option so a consumer can set they want to do extreme data saving, moderate data saving or no data saving at all.

And so we'll evolve to let the users just do it. But the advantage of doing it for people in the past was to save on -- to avoid those data plan overages that are pretty unique to mobile.

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**Peter Kafka** - *Re/code - Analyst*

And that option you're describing where you can opt in what quality you want, is that a reaction to the stories that came out the last few weeks?

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**Reed Hastings** - *Netflix Inc - CEO*

No, we've added lots of options over time to allow more customization. If you look, we've had one on the wired side, we just hadn't implemented it yet or rolled it out on the mobile side. So it's always been planned.

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**Peter Kafka** - *Re/code - Analyst*

Another regulatory question or FCC question. The open set top box proposal that President Obama has endorsed, if that goes through, what changes or options does that open up for you?

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**Reed Hastings** - *Netflix Inc - CEO*

For us, the open set top is the Roku or the Apple TV or the SmartTV. It's a basic internet device that runs apps, and that's what we think the future is is that kind of broad openness. And we don't really follow very closely like the intricacies of the cable set top industry in the US, as opposed to these great global platforms that are IP centric like a Samsung SmartTV.

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**Peter Kafka** - *Re/code - Analyst*

So it's not meaningful to you if it goes through?



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**Reed Hastings** - *Netflix Inc - CEO*

I don't think so.

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**Peter Kafka** - *Re/code - Analyst*

Thanks.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Ted, I want to ask you a little about your relationship with your major suppliers. You, I'm sure, hear the rhetoric as we do growing out of Hollywood. Maybe start with Disney. How is that relationship today? They've obviously come under some pressure around ESPN and cord shaving.

But is your relationship with Disney as strong as it's been? And should we expect that you may be able to expand your Marvel TV relationship in particular? And I'd love to hear any sense for how Daredevil season two is performing, and performed relative to the first season where that audience built.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

Sure. These have always been relatively complex relationships where you are both supplier and sometimes competitor. So in the case of Disney, they're a major supplier and they're our producing partner where they produce our Marvel Defender series. We just kicked off our fifth season of production on this show. It's a very lucrative piece of business for Disney, obviously, and a great partnership in that way.

There's no way to isolate the two sets of businesses completely. So while they're a great producing partner, they're a great licensing supplier and we're always trying to figure out ways that we don't bump into one another competitively, but sometimes it's inevitable.

Daredevil season two was fantastic. The critics loved it, the viewing numbers have really grown. We've added an enormous number of people to Daredevil season one, both because of the excitement around season two and that we're in additional territories now that didn't have the opportunity to see the show in the first go around. So it's been a real success, and we're really excited to be in business with them.

All of our suppliers either produce for us or license to us and probably compete with us on some level, and we're just always trying to navigate those waters. Very similar to the way networks deal with one another and produce for one another.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Did the changes you're seeing out there impact the timing with which you may get to your 50/50 split of original spending and acquired? And you threw out in the letter 5% of your spending I think today is on films. How would you fit film spending inside of that 50/50 mix long term?

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

Right now, we're trying to complement our film selection between aggressively ramping up our global originals with films that people want to see everywhere in the world, plus licensing where opportunistic. We've been doing pick-ups of films at film festivals, particularly ones that have broader commercial appeal. Like next month, we have a film called The Fundamentals of Caring with Paul Rudd that I think fans are going to really love when we launch that around the world.



Then regionally, we're also doing some opportunistic licensing. As you know, we pick up the Disney pay one output later this year. And we also just in this quarter we'll have the Minions, we'll have Goosebumps, we'll have Hotel Transylvania 2, and we'll have the film that won the Academy Award for best picture, Spotlight, exclusively on Netflix in the US.

So it will be hard to comp against those numbers as we're ramping up films, because we still have a great selection of other films as well. But we're going to keep pushing at it. There's no mandate or no initiative to how quickly we're going to get there, and success, we just want to keep pushing it forward.

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**Reed Hastings** - *Netflix Inc - CEO*

Later this week, we'll be releasing the first trailer for The Do-Over, Adam Sandler's next film for us. The trailer is incredible. I think you're going to find that this is a movie that really delivers for the Adam Sandler fans extended.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

That will be global, it's available globally as well in May.

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**Peter Kafka** - *Re/code - Analyst*

Reed, maybe, Ted, if I got on a plan I can download some of Amazon's -- I guess all of Amazon's original content, some of their studio stuff they've licensed and take it with me for off-line viewing. YouTube Red lets me do that. Why not offer that for some of all of your content?

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**Reed Hastings** - *Netflix Inc - CEO*

We should keep an open mind on this. We've been so focused on click and watch and the beauty and simplicity of streaming. But as we expand around the world where we see an uneven set of networks, it's something we should keep an open mind about.

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**Peter Kafka** - *Re/code - Analyst*

This one's a little more future, off in the distance. But how long do you imagine before some combination of VR, AR, 360, any of the stuff you see people experimenting with on Facebook, YouTube, becomes relevant to what you do?

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**Reed Hastings** - *Netflix Inc - CEO*

I think it's mostly going to be an intense gaming format for a couple years, due to the price of the consoles. So think of it like the Playstation 5 or the Xbox 2 or something. It's heritage to console gaming will be a lot of that market. And then everybody hopes that it matures into something that's lower cost and more ubiquitous.

So I don't think it will have a direct effect on us in the next couple years, because I think the centerpoint for VR will be other sorts of things than watching a TV show in a VR headset. I don't think that will be very popular.

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**Peter Kafka** - *Re/code - Analyst*

Thanks.



**Ben Swinburne** - *Morgan Stanley - Analyst*

David, turning to some of the financials, you gave some color for the year around contribution losses internationally. I think looking for something around \$370 million for the year now, which is less than at least you had articulated and we had thought previously.

What's driving that improvement? And it sounds like that's a focus for you as you head into next year. Maybe you could spend a little bit of time talking about what's moving the international losses lower and how that may trend into 2017.

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**David Wells** - *Netflix Inc - CFO*

Well it's nothing more than growing revenue faster than your content spend. So I think it's just the fact that we've got multiple markets now that are improving year on year in terms of growth and economics, and we stack them together and you've got a picture where collectively, they're covering any of the new markets that we could have launched this year. And then next year or the year after, depending on the size of that market, they could be covering them all.

I think we're giving ourselves a little bit of flexibility. Because the more of an opportunity we see, the more we may put back into the business in terms of additional investments in content. But we feel like today that we can do all of that and still grow operating profit, which is why we continue to make the statements about meaningful operating profit next year. But we feel like we can do both.

So I don't think -- internally, there isn't a different plan. Perhaps versus expectations, people felt like there might be higher losses internationally. But it's been fairly consistent I'd say over the last three to six months.

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**Reed Hastings** - *Netflix Inc - CEO*

Do you want to talk about the weakening of the dollar and how that affects us?

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**David Wells** - *Netflix Inc - CFO*

Sure. So we did highlight this in the letter, and you live by the currency, die by the currency in terms of the fluctuations. Last year, we had a lot of headwinds, especially on the international revenue line.

We had to explain why our international average subscription price was flat in certain quarters when it still was growing. This year, we're seeing the reverse of that with the weakening of the dollar. At least in the first part of the year here, where international contribution margin is benefiting from that so we did highlight that for you in the letter. Thanks for pointing that out.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

David, as a follow up, you're doing more and more global deals. Could you just remind us how you're allocating licensing costs, and whether that's having an impact on the quarterly movements in margin?

You guys guided to I think a sequential margin stepdown in the US. How much is the allocation issues or allocation thought process impacting those moves?

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**David Wells** - *Netflix Inc - CFO*

Part of that, or the US P&L or the US contribution margin, we've said this before, I'll reiterate it, is definitely benefiting from the fact that we're launching more international markets. So the cost of that global original that Ted talks about is being spread by more markets. There's some relief to the US P&L, and in terms of the allocation mechanism, it's really by media market value.

So in the early days, we were doing it by broadband households. That was overcharging certain markets where if you had a very knowledgeable experienced media buyer in the market they would say well there's no way that anyone would pay for this particular title at this amount in the market. So we refined that to a media market value that's validated by some third party survey information, and I would say in general it's vetted by our own buying team internally as to what would be paid for that particular title in the market.

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**Reed Hastings** - *Netflix Inc - CEO*

And then margin being tight in Q2 is really related to the large amount of content and associated marketing for launching those content that we're very fortunate to have.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Thank you.

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**Peter Kafka** - *Re/code - Analyst*

You guys are moving people towards a \$10 a month price point in the US. For the folks who have the \$12 plan, what are they using that for, are they using it to get high def, are they using it for four streams? What's the usage pattern for those customers.

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**Reed Hastings** - *Netflix Inc - CEO*

Ultra high def 4K is becoming quite popular. We're the leading source of ultra high def content now. Ultra high def televisions are for sale at Best Buy and Costco. So we're seeing that ecosystem development. And if you pay \$1,000 or \$2,000 for a 4K TV, it's pretty natural to bump your Netflix to the \$12 plan in the US, and about equal internationally to be able to get access to that 4K streams and see what your TV can really do.

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**Peter Kafka** - *Re/code - Analyst*

So that's the majority of the people who are paying you \$12 are using it for the ultra high def?

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**Reed Hastings** - *Netflix Inc - CEO*

That's right. The video quality is really the big driver. And similarly our standard def plan, which is DVD quality, is great for people, \$7.99, and so that's a really strong option too. So we're not trying to bias people. We're trying to help them make a choice that they feel great about, and that they'll stay with. So think of us as really investing at both ends, the \$7.99, \$9.99 and \$11.99.

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**Peter Kafka** - *Re/code - Analyst*

You spell out in your letter that the price hikes that are coming this month, next month, that you'll be staggering them throughout the year, it's not all going to happen in one fell swoop. Is that a change in plan, or was that always the direction you were going?

**Reed Hastings** - *Netflix Inc - CEO*

That's always what we thought. It's a little bit cautious, but it won't hurt. We don't particularly need the revenue in the short term, so it's fine to just spread it out.

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**Peter Kafka** - *Re/code - Analyst*

Thanks.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

David, just coming back a couple more on the numbers. The content, sorry, the contractual obligations were up to I think \$12.3 billion at the end of the quarter, which was a bit of a jump from the end of last year. Is that the Disney pay one deal kicking in or any other color you'd add as to why that number inflated a bit?

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**David Wells** - *Netflix Inc - CFO*

It's really the Netflix global launch. So you've got to think about it as, we're adding more content now for the rest of the world. It's our newer markets as we add more content, those markets are growing in content spend more quickly than some of our more established markets.

So you combine those, and I think what you'll find is if you take that obligations number over our average membership for the quarter, it's still in that band of about 150, 160. And it really has only popped up this quarter because of that new launch basically of Netflix global.

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**Reed Hastings** - *Netflix Inc - CEO*

Remember on Disney, we have pay one today in Canada and then we'll be adding it this fall in the US.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

And just on the cash outlook, cash flow outlook, should we still be thinking about a \$1 billion burn this year and any color for next year? And when might Netflix generate substantial free cash flow?

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**David Wells** - *Netflix Inc - CFO*

So no change on the outlook on either this year or next year. I would say \$1 billion is a pretty good guide for both this year and next year.

And really on free cash flow positive, it really it depends on the size of the business. It depends on how much more we'll continue to grow the content, which does depend on the size of the business. So on that one, I will turn the question around and say how big will we be and then I'll tell you when we'll be free cash flow positive.

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**Reed Hastings** - *Netflix Inc - CEO*

You how big we'll be, and then how crazy does Ted go on these productions. And what we've found is that these really big productions like The Crown are just terrific for us in global brand building. So we're very excited about being able to deploy the cash to create shows like that and like The Get Down that's coming this fall also.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

You should think about it that those big productions play much more like big block buster film. And the fact that not only do they get more watching in the US, but they travel much better too. So you see in all these non-English speaking territories, these series performed very well.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Reed, I was going to ask you, because I think you were quoted in The Guardian talking about or predicting spectacular budgets for TV series. Are your comments just now reflecting that expectation, and does that suggest a reduction in the return on spending that Ted's doing?

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**Reed Hastings** - *Netflix Inc - CEO*

No, it suggests an increase in return on spending if anything. That is, when you spend on the big items they go much, much further than a whole lot of substitutable content. So we're interested in both spectacular content and spectacular membership growth.

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**David Wells** - *Netflix Inc - CFO*

What we've found is that people globally love high production quality content.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

It's why US content has traveled the world historically so well because of the production value that you're seeing. So when you see things like the next month, we'll have our fourth season of Orange is the New Black. That was kind of a surprise to most people in that it didn't have any of the established movie star talent that some of our other shows have, but it had built up just on the quality of Jenji's storytelling, and then the spectacular cast and the ability to get to know them better. And that as we enter its fourth season now, it's got tens of millions of fans around the world that can't wait for that show.

Sometimes you can get that built-in excitement with somebody who brings their own draw and their own star power like a Will Smith movie or a Brad Pitt movie that comes out, or Naomi Watts starring in a TV series for Netflix or Drew Barrymore starring in a TV series for Netflix. This is a way people can more quickly get the to know some of our newer IP.

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**Reed Hastings** - *Netflix Inc - CEO*

And Orange is only 60 days away, June 17.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

June 17.

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**Peter Kafka** - *Re/code - Analyst*

Does that bigger, better, super size it attitude, is that going to apply to feature films that you'd like to release theatrically? Could you do a Star Wars size production, or does the pushback from the traditional cinema distributors prevent you from really going whole hog on a movie like that?

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

You should look at our original films as similar to a slate of studio films. And that's -- FOX did have Star Wars this year, but they also had Brooklyn and a lot of things in between and that's what we're looking at too. Whether or not a movie at the Star Wars level makes sense yet, we'll see, but we're ramping up.

You saw recently we announced that we're doing the next Will Smith movie called Bright with David Ayer directing which is a big-budget summer movie. In fact, it will be David and Will as soon as they come off of Suicide Squad, that's their next film and it will premier on Netflix in 2017 included in your subscriptions costs. So while we're all debating around big ticket, day and day pay-per-view, we will be debuting that movie on Netflix included in your subscription costs all over the world.

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**Peter Kafka** - *Re/code - Analyst*

But you're not going to the tentpole strategy the big studios have gone to yet, where you're doing a handful of very, very large productions, you want a range of them.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

A range of productions, correct.

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**Peter Kafka** - *Re/code - Analyst*

And then you mentioned the day and day debate. You've seen that directors come out and say we like the idea of playing with the window, what's it called, the screening room product. Does that mean anything to you, is that something that you guys could participate in?

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

No. Like I said, we wouldn't mind having our films available in that product to the extent that people want to see it. Our focus is on movie lovers and movie fans, and trying to get them the content that they want at reasonable prices in great windows.

So for us, being able to produce our own films, gives us more control over those windows and the quality of the films themselves. So screening room to me would be a great way to get the content in front of consumers if they're willing to pay for it.

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**Peter Kafka** - *Re/code - Analyst*

Thanks.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Reed, you've talked historically about a 60 million to 90 million subscriber opportunity in the US. And I'm just wondering as you sit here today, if you can update us on your expectations long term in the US market? Is there anything that you think needs to happen that isn't happening today to get you there? For example, whether [MVPD], set top distribution, broad distribution in the US from say a new Charter or a Comcast would really help accelerate the growth in the United States.

**Reed Hastings** - *Netflix Inc - CEO*

It helps a little bit. We're integrated with Suddenlink in the US which is about 1 million subscribers, and of course in Europe we're integrated in many platforms. But think of it as the fundamental draw of internet TV. You can get it on a SmartTV, you can get it on an Apple TV, so there's a lot of ways around it where we don't have that distribution on cable. But it's one more platform, and all platforms are good. It's not something we need to say get to 60 million to 90 million.

And we're continuing to see just that steady growth. To have 2.25 million net additions in the US in Q1, basically the same as the prior two years, it just felt great. So we're really excited about what the new content as it builds is able to do for us.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Ted, one of the things we hear from particularly investors in Europe is just that there's a limit to how far US exports can get you. I don't know whether you agree or disagree with that. But I'm just wondering if you think, particularly in markets like Europe and France who might have let's say unique content tastes, that you need to go more local with your spending in those markets and maybe some of the earlier international markets for example.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

Well I do think that what's popular in a market is much more a reflection on what's been available to that market over long periods of time. So what we've been really encouraged by is just how international our original series have been.

So you take a non-English speaking territory, you spoke about Brazil earlier, and not only is it not English speaking it's a non-Spanish speaking Latin American territory. And in the last 30 days, eight of the top ten most watched things in Brazil have been Netflix original series. So these shows play very well, throughout Europe as well.

Now that being said, we think it's worth it to complement the selection by focusing on some local productions in those territories throughout Europe and throughout Latin America. So Reed had mentioned, but on May 5, we'll launch Marseille, which is our first French language show filmed in France starring Gerard Depardieu. We're also filming original series in Spain, in Brazil, in Italy. So we're definitely investing in local language content, particularly in those markets that have shown some desire for more local programming, but as a complement to our global offering.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

And, David, does that mean by default those markets may be lower margin than the US market long term?

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**David Wells** - *Netflix Inc - CFO*

No, I don't think that's what Ted is saying. I don't think you can equate the two. Even when we're looking for a local original like Marseille, we're considering the economics of that production based on the total French diaspora. So not just people in France, but people outside of France that are interested in French language content. So I think you can -- you can't necessarily equate those two, and we preference the content when we're developing those local originals for things that have potential demand outside of the original market that it's produced in.

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**Reed Hastings** - *Netflix Inc - CEO*

And our Japanese original, Hibana, for example, we're launching this quarter and that will be available globally. So think of all that content we're developing it locally, distributing it globally and connecting the world through that. We think that's a very powerful formulation that will help us grow for many years ahead.

**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

The Marseille example, Gerard Depardieu is the biggest star in France, and one of the biggest stars in the world. And we have about 2 million people in the US who watch French language television regularly on Netflix. So that's what we're talking about the scale that we could bring to a production like that for France and Europe, but really for the world.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Thank you.

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**Peter Kafka** - *Re/code - Analyst*

Ted, what's your biggest non-English speaking audience in the US? You said France is 2 million. French is 2 million.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

Probably Hispanic, I imagine it would be Hispanic.

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**Peter Kafka** - *Re/code - Analyst*

Makes sense. Reed, were you surprised that HBO said they had 800,000 subs after about six months going head to head with you as a standalone product?

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**Reed Hastings** - *Netflix Inc - CEO*

A little bit. I think it's a great product, I use it all the time. But then I think for many other people, they probably just subscribe to HBO and cable and they're used to that.

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**Peter Kafka** - *Re/code - Analyst*

So you thought the number would be higher than 800,000?

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**Reed Hastings** - *Netflix Inc - CEO*

Yes, just because I find it -- the thing I like about the HBO Now is it's just easier to use. You can use it on the mobile. You can use it on many different internet platforms, but then I'm pretty internet centric. Apparently, I'm not as typical of the audience.

But they're continuing to do great work. And what that does is just reinforce to the consumers how great this new internet thing is for TV, and it just sets the drum beat. So I hope they continue to have more and more success.

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**Peter Kafka** - *Re/code - Analyst*

Ted, there's more money coming into the market for programming, HBO, Showtime, Starz, you guys, Amazon, Crackle is getting into it. Verizon is spending a lot of money.



**Reed Hastings** - *Netflix Inc - CEO*

CBS all access, I've got a list. And that's just in the US.

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**Peter Kafka** - *Re/code - Analyst*

Does that number continue to get bigger in perpetuity, or does it retract at some point and people say all right, we've over done it and we're going to pull back on spend?

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**Reed Hastings** - *Netflix Inc - CEO*

It's hard to tell. People talk about the growing content spend. But what we're able to do is find the shows and get the shows that we want and we do have to pay a lot more them.

But coming back to the phrase earlier, they're really spectacular what we're doing. And I think when you see Orange, when you see The Get Down, when you see The Crown, you'll know why we're investing in what we do.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

Peter, I think it's a debate around how you to best monetize your content. And if you believe you can over the long haul best monetize your content with your own app, then you'll go that path. If you believe you can best monetize it by licensing it to Netflix, you'll go that path.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Reed, what's been the feedback initially from members around your price points in the rest of world markets you launched in January? Obviously, relatively expensive versus existing pay TV or entertainment options. Any thought about changing your global price point approach in those markets?

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**Reed Hastings** - *Netflix Inc - CEO*

We really haven't seen price be much of an issue. But then today, we're serving English language speaking elites around in these countries.

So in the model that we're doing and targeting the high end, the price is fine. We'll see over the coming years as we expand and we may need some flexibility eventually. But nothing in the short term.

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**Peter Kafka** - *Re/code - Analyst*

Why don't we do the last two questions here.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

I was just going of to quickly follow up on that topic and I'll hand it back to Peter for the last one. David, you guys are working on more local language offerings, better payment processes, other operational improvements in those rest of world markets. What's the timing there, should we be thinking about that through the remainder of this year or is it a longer term time frame?

**David Wells** - *Netflix Inc - CFO*

It's kind of both. So you'll see some this year, but really it's about the next two to three years in terms of improvement. We've only just started skimming these markets. So we'll be looking at them opportunity by opportunity, and you'll see some this year but you'll see some continued into next year and even into 2018 I think.

We have a big opportunity in front of us, as Reed of pointed out. Many of our internet peers have a dramatically larger business outside of the US versus inside the US. So we're pretty excited about that opportunity.

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

I think one of the really exciting parts about being in all these countries is being able to discover the next great storyteller for the world. So because we're more focused thinking about India, where we weren't thinking about it at all a couple of years ago, we acquired this great film called Brahman Naman at Sundance this year that we'll be premiering around the world in June. And it really is a discovery of a great Indian director named Q who I think everyone's going to be talking about over the next few years, and having that kind of global sensibility increasingly is going to help the programming for everybody not just the subscribers in those countries.

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**Reed Hastings** - *Netflix Inc - CEO*

And so in a movie like Brahman Naman, it's in English, so it's accessible to many people. But YouTube has over 50 languages, we only have about 20. So that scales for you roughly how far we've got to go.

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**Ben Swinburne** - *Morgan Stanley - Analyst*

Thank you.

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**Peter Kafka** - *Re/code - Analyst*

You guys are moving into more and more kids content. Does it make sense for you to eventually own the IP yourself instead of licensing it through Disney or Dreamworks so you can create ancillary revenue streams?

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**Ted Sarandos** - *Netflix Inc - Chief Content Officer*

We do a lot of both. The consumer products addition to those projects relative to the content value itself is pretty small. But we could look to optimize that stuff down the road.

In Q2, we're launching nine seasons of original kids content, including a new season of All Hail King Julian which is nominated for a daytime Emmy. This year, we have 33 daytime Emmy nominations for our kids content across seven of our different shows. So we're really focused on building up the quality of that programming that's exclusive and original to Netflix.

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**Peter Kafka** - *Re/code - Analyst*

So a Ted Sarandos land or a Reed Hastings land at some point?

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**Reed Hastings - Netflix Inc - CEO**

We were going to nominate as Kafka land. So to wrap up here, I wanted to thank Peter Kafka who's been with us these last few calls and is retiring from this side job. And thank you for your involvement in this.

And to all the investors, thank you for your support. We had just a great quarter with 6.5 million net adds, over 81 million subscribers. We cannot wait to break through 100 million subscribers sometime next year. It's going to be a big celebration. We're looking forward to it. So thank you very much.

**David Wells - Netflix Inc - CFO**

Thanks.

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