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# EDITED TRANSCRIPT

NFLX - Q4 2014 Netflix Inc Earnings Call

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## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

**Mark Mahaney** *RBC Capital Markets - Analyst*

**Rich Greenfield** *BTIG Research - Analyst*

## PRESENTATION

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

Hi, this is David Wells. I'm the CFO of Netflix, and I'm welcoming you to the 2014 Q4 earnings interview. Joining me today is Reed Hastings, our CEO; and Ted Sarandos, our Chief Content Officer, is joining us from Miami at the National Association of Television Executives meeting. Also at that meeting is Michael Nathanson, and with too many conflicts. So reprising his role as interviewer today is Rich Greenfield, analyst from BTIG. And joining him is Mark Mahaney from RBC.

We will be making forward-looking statements today. Actual results may vary. I'm going to turn you over to Mark, who has our first question.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

Thanks, David. A question to start off for Reed. You had talked about an S curve and the ability to get to 60 million to 90 million subs in the US. And you beat the sub numbers for the quarter, but there's a year-over-year reduction in net sub adds. So walk us through what your latest thinking is on the ability of Netflix to reach 60 million to 90 million US subs.

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

Well, it's looking very good. We're at 39 million in the US, adding 5 million-plus a year. So that trajectory is great. And if you step back and you say -- is Internet video going to be in every home in America in 10 years? That's a pretty clear yes. So, tons of potential there, and we're very excited about just continuing to improve our service.

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**Rich Greenfield** - *BTIG Research - Analyst*

This is a question for Reed. When you think about the international growth profile, the comments that you made in terms of the cadence of market launches -- basically saying that every single market would be launched over the course of the next two years -- was a pretty big move from what I think we were expecting, and what I think investors were expecting. Was there something that happened when you looked at the success you were having overseas, whether it be France, Germany, Latin America? Did something happen to change how fast you planned on rolling out the rest of the world to get you over the next two years?

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

Yes, Rich, there's two real drivers. One is the success that we've seen from Argentina to Finland, to have all of our first wave of markets from Canada, Latin America, Nordics, Netherlands, UK and Ireland be profitable together as a group. It's just a tremendous accomplishment. And that the growth rates that they're seeing, it's going to be very significantly profitable going forward. So that's been a big driver for us.



And then I think Ted really had the vision to figure out how to start to get global rights for some of the content by moving up the food chain. And we've been pushing on that dimension to be able to get the global rights where we don't have to go country by country across 200 countries, but instead, can provide the producer upfront money, guaranteed money and get great access. Ted, do you want to add to that?

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

Yes. I think our success this year with *Better Call Saul* and *Gotham*, where we had moved up the process, licensed for all of our operating territories and our future operating territories directly with the producers of those shows. So, *Better Call Saul* directly with Sony, and *Gotham* directly with Warner Television, instead of going country by country and piling of those deals and lining up windows. This enables us to make the service, the selection for more global for viewers around the world who increasingly know exactly when these shows began, and are hungry to see them as soon as they can.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

Question for Reed or David on the international sub numbers. They came in materially higher in the December quarter, and your guiding for materially higher than expected numbers for the March quarter. Can you give us any color on which markets and which countries did better than expected? Or was this just the case of the European launch being a little more delayed than expected and you're seeing the full impact of that? Where was the upside from?

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

Mark, this is David. It's across several markets. As you know, we don't talk specifically about individual markets for competitive reasons. But I would say it wasn't driven by any one individual market, it was driven by several markets. So we're really pleased with the growth that we saw in the fourth quarter and carrying into the first quarter.

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**Rich Greenfield** - *BTIG Research - Analyst*

If I could just follow up, David, on that question on Latin America though. You did give out a 5 million subscriber -- that you had reached 5 million subscribers during the quarter in Latin America. Could you give us any other feel for -- are there any other milestones to think about as you think about other markets that you've already launched that we should be thinking about? And why you're disclosing something like 5 million in Latin America without more detail overseas?

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

Well, it's a nice round number, and we'll be giving out milestones as we hit them, I think, in other markets. But it's incrementally better for us to talk about that with consumers in Latin America because it validates the quality, the breadth and the size of the service. It's helpful from a consumer standpoint in the market. So we weigh between the investment community and the consumer community what's helpful, in terms of incremental information.

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**Rich Greenfield** - *BTIG Research - Analyst*

What changed that actually accelerated? Because it was an area that you had talked about as a problem, historically, on these calls. Why is Latin America now accelerating to the point where you're now really getting excited about the growth potential?



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

Well, nothing changed. We knew we would hit 5 million in the quarter, and we did. What changed maybe -- that we give you incremental information. I think what we've said all along, in terms of Latin America, it was a challenging market. We've had payments issues and e-commerce trust issues that we've wrestled with and improved over the last 3 to 3.5 years, but it's been growing all along. I think either folks may not have taken us at our word for that, but we're very pleased with it. It's been steady growth.

We continue to see great growth and great potential in the market. It's a market with about 65 million broadband households. If you take that 5 million number that we talked about, and 65 million in terms of addressable, we think we've got a lot of room for growth in the market.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

David, I want to follow up on the global expansion. One of the two things you bolded in this press release was this line about completing global expansion over the next two years. I noticed the bolded stuff. The question is -- you talked about this a little bit before. It sounds like you're buying international content or getting content for international markets more efficiently. Are there learnings from some of the international markets, the launches you've had to-date, that have allowed you to be more efficient in rolling out new markets going forward? It's pretty big statement to make and pretty big change just over the last 90 days.

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

Sure, Mark. I think one thing that I would add to what Rita and Ted talked about in terms of our incremental confidence in international is that our originals programming continues to be highly engaged across markets outside the US. We thought it might be, based on the type of content that those markets were enjoying. But we just didn't know.

And now we've had another year of experience in originals. We see that the originals are in the top list of content watched in all those markets. So it gives us more confidence that when we make something, we produce, we incur those production costs, that it will be an asset that can be enjoyed across markets and across a bigger and bigger set of international markets. So, I'd say -- go ahead, Mark.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

No, please finish, David.

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

I would say the incremental lessons for us have been -- the payments lessons we've learned, and we continue to grow and address each individual market separately, because they all seem to have different challenges. The types of programming in each market, I think, Ted's team is getting smarter and smarter, and we've become incrementally better in terms of knowing what to license up front, what to add, in terms of licensing over 12, 24 months, to make the content better and better.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

I had a brief follow-up, and just to bring the question back to Reed, then. Reed, is the point that Netflix is really selling two universal goods? One is streaming, and the second is streaming of this content that has universal appeal, a lot of which is US content. Not all of it, but the most popular shows in one market pretty much largely transfer to be the top content in other markets, as well. Is that the secret sauce?

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

Well, I'll certainly chew on that first part of what you said, which is the magic of streaming is on-demand, in control, being able to binge on episodes, watch a movie in the middle of the night. And that is a very universal truth, which is even stronger in developing markets where television is not as advanced as it might be, say, in the US or France. So the more that we expand out of that footprint, the more we are differentially great with the interactive side.

Then in terms of the content, it would be easy to over-generalize from our experience in Western Europe and Latin America. There's some content like House of Cards that really does carry around the world. It's not on our [serve]; it's in China. But it's been tremendously popular in China. But not every piece of content will carry equally well. But we've certainly been impressed on how there's a segment of the market in every country that follows Western, Hollywood, British content. And then we're augmenting that with all kinds of local programming.

So it's not quite as simple as we do our originals, that's the whole thing, it's everywhere. But that's at least a two-thirds impact. And Ted, maybe you can add some color on how we look at the markets beyond Western Europe?

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

Yes, it's been so encouraging how truly global these brands have been. When we set out our original programming from the beginning, obviously our markets were pretty limited, and we were thinking about them mostly as US shows and they would travel like other US shows have. We've been really enthused to see -- particularly in our Western European launches -- shows like Orange is the New Black and House of Cards, even in later seasons, performing tremendous for us. Because people hadn't got around to seeing them yet, and we could get the brand out there and push it out there. And then Marco Polo was kind of a global phenomenon, as well.

So to us, it was very encouraging that what the world really wants is high-quality, big production values, great storytelling, and that can be truly universal. It might be that there are some cultural barriers to US content as we get into more exotic markets. But my guess is, is that we're going to continue to see our original programming travel and carry the Netflix brand around the world.

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**Rich Greenfield** - *BTIG Research - Analyst*

This is a question for Ted, because you bring up Marco Polo. I think the impact on the fourth quarter is really important to hone in on. We got a lot of questions e-mailed into us basically with the sentiment of how much of a drag was Marco Polo and the negative reaction on Q4 subscriber metrics? Did the negative press impact, negatively, gross additions?

And then tied to that, as you've mentioned also, you've got House of Cards, Season Three coming. How much of your guidance for Q1 benefits from Season Three of House of Cards, globally? I think last year, you made a comment that Season Two had, had a much bigger impact on gross additions than the prior year. Does that follow through, you think, again for Season Three?

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

Rich, I think it's tough to get a big subscriber reaction to a new series that people haven't heard before, even if they get excited about it. They're more curious about it before they've seen the first few. While Marco Polo had some negative reactions in the press, viewers have loved it, and the volume of viewing has been phenomenal. The rate at which people are completing the show is comparable to our other big tent-pole original shows. So we're thrilled that we made a show that viewers have loved around the world. And of course because it's a Season One, we had not baked in or had a big anticipation for subscriber impact.

House of Cards, Season Two; Orange is the New Black, Season Two; and Arrested Development have been the ones that -- the shows where we've been able to track real measurable subscriber growth with their launches. And I think as we go forward with Season Three of House of Cards and



Season Three of Orange Is the New Black -- Daredevil has a built-in fan base from Marvel. Our feature film -- Crouching Tiger, Hidden Dragon II -- has a built-in fan base from the original film. So I think we'll see those kind of impacts that we saw from Season Twos in the past.

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**Rich Greenfield** - *BTIG Research - Analyst*

Because part of the fear is that the marketing benefit that came along with originals that had good reviews had a big impact on just building the Netflix brand. And obviously, Marco Polo -- maybe it's getting good consumer reviews. But the critical press or the media, the general entertainment media, doesn't seem to be excited about it the way they had been about your prior originals.

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

I find it hard to believe that you can build sustainably on things that get well-reviewed and not watched. So I'm thrilled that this is getting watched and loved, and I think that is sustainable.

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

And Rich, we're really focused on the consumer and the social media that comes out of that. So if you look at the commentary from people to their friends about Marco Polo, it's extremely positive. The spectacle, the costumes, the story line, the exotic-but-approachable -- it's a great one. The investor audience tends to be highly educated, and that really skews towards House of Cards. But, well, you're an exception. (laughter) So you get some of that marketing-to-me kind of thing, where House of Cards for the investor audience is a tighter match than Marco Polo. But really, Marco Polo has been a great success, and we've renewed for Season Two.

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

And Rich, one final comment regarding guidance. It's worth reminding folks that the investment community is hyper-focused on whether we're within 100,000 or 200,000 of our guiding number. But when we're talking about our guide for Q1 at 1.8 million domestic members, in terms of growth, the addition of even House of Cards, Season Three is 100,000, 150,000. So we're talking about -- on the margin it's helpful, but it's not the big thing that's going to drive the growth in Q1.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

Let me go back to Ted with two questions on original content. Does the success, then, of Marco Polo want to lead you to look to do even more of these relatively blockbuster type of productions?

And then secondly, in terms of the viewing of the season, just to be clear, are you seeing greater viewing of each of the original content -- House of Cards, Orange is the New Black? Are they increasing every year as you've seen really successful series do in the past? Are the audiences building up for each of those?

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

The audience is definitely building season-on-season for each of those shows. And I think, as you see in our line-up of upcoming shows, that we have some pretty epic and pretty spectacular shows upcoming -- like Daredevil, like Sense8 -- that are done on a very big scale.

But remember, we're releasing 320 hours of new original programming this year alone. And in there, there's a mix of big epic spectaculars. Some smaller productions, but I probably think equally loved, like a comedy from Tina Fey and Robert Carlock, the Unbreakable Kimmy Schmidt. And



other shows, as well, like Grace and Frankie, with Jane Fonda and Lilly Tomlin. So we're not going after one kind of audience or one type of show. Tastes are super-diverse, and we have a big subscriber base and were trying to serve all of them.

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**Rich Greenfield** - *BTIG Research - Analyst*

When you look at the subscriber growth, David, obviously, you're looking for slower growth or slower net adds, as you look on a year-over-year basis. Should investors just assume that a 20% annual decline? Or is the content that Ted's talking about, is there the potential to re-accelerate that, where you could have more adds domestically in 2016 than 2015?

And then tied to that, you gave out, I think, your first-ever margin guidance for 2020 of 40%. Was that tied to a specific subscriber number in your head? Or is there a pricing flexibility, where you think pricing is notably higher? How do we think about how you get to that 40% contribution margin?

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

Sure. Well, I'll take the first part. We certainly could end up higher, right? Now, we've learned our lessons on giving full-year guidance on member numbers, so we tend not to do that. But what we're saying is -- look, the current trends that we saw in Q3 and Q4, extrapolated forward, are down year on year, in terms of net addition growth. We have a lot of content, as Ted just talked about, coming out in Q1 and the rest of 2015.

So we certainly could see it jump up. It's really hard to know. But I think the prudent thing for us right now is just to continue to extrapolate the current trend that we're seeing. And that was down year on year, and that's what you see reflected in our Q1 guide.

In terms of the margin guidance for 40%, it isn't the first time. We actually guided to 30%, in terms of setting a margin target out there. But we wanted to give investors some guidance in terms of long-term margin growth. And what it's about for us is the steady march upward of about 200 -- averaging about 200 basis points a year.

We're going to have some lumpiness with the content coming in, in terms of heavy quarters of content introduction. We have accelerated amortization on that original content, which tends to pressure the P&L in those quarters when we launch a lot of content. But I think for the 40%, it's the continued steady growth of the business. And we think that we have the flexibility in the model that doesn't require an 80 million subscriber or 90 million subscriber business to get there. We can get there with the growth that we see layered in today.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

David, can I ask about pricing elasticity? You talk about that a fair amount in the press release. Two quarters ago, it seemed like there was a lot of conviction in the pricing power. Last quarter, some questions. Now, it seems like there's greater conviction. Do you think you really have enough data points? I know you mentioned Mexico. It sounds like you did some additional research on some of the newer subs coming in.

Do you have other markets that you've looked at and you've seen the results from there that give you the confidence that there is this pricing elasticity or pricing power? Do think we could, then, going forward, see a \$1 price increase every other year, or every two years, and maybe with a year grandfather?

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

Well, I don't think we're talking about \$1 to the consumer price increase every year. What we're talking about is using our tiers to provide value and choice for the consumers to steadily grow our average subscription price over time. That doesn't necessarily require the frequency of an annual price increase. I think what you should expect from us is a steady growth of that ASP, and we'll disconnect pricing. I don't think there's any reason for us to have a global single event. We'll look at pricing in each market and we'll grow it accordingly to what we think makes sense in each market.



In terms of evidence, sure, we have seen growth persist through pricing introduction or raises through those markets. So I think besides Mexico, we've got some other examples. Ultimately, it will rest upon when those grandfatherings expire. So we still have that to come.

But we think we have enough evidence today to look at it and say -- the growth that we saw that slowed down in Q2 and Q3 wasn't necessarily -- wasn't related to the pricing. We still scratch our heads a little bit, in terms of explaining fully. And as I said before, it takes several quarters for you to really get comfortable in the answer and to look at every piece of information. But right now, I think we've got enough information to say, based on Mexico and other markets, that there's still pricing power, plenty of pricing power for Netflix, and not a reaction to the elasticity.

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**Rich Greenfield** - *BTIG Research - Analyst*

Just expending on that, Reed, when you think about the way you price, you basically foreclosed on advertising as an incremental way to drive revenue. Are there forms of tiering that could actually be interesting to generate more revenue for Netflix on a per-subscriber basis?

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

Sure. The biggest one is our \$12-a-month plan, is our plan for Ultra HD. Today there are very few televisions that are Ultra HD, and we only have a few titles. We have more than anybody else, but we only have a few titles. But if you look ahead two years, four years from now, many of the TVs sold at Best Buy will be Ultra HD, and lots of our content will be Ultra HD. And it's a natural match.

So I think what we'll be able to do is, as the high-end of the market spends \$2,000 to get an Ultra HD television, it seems fair and natural to them that, just like you pay for a difference between standard def and HD, that there's a difference between HD and Ultra HD. That's a way that we get incremental revenue without making any changes ourselves, by just letting the tide come to us.

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

And Reed, if I could add to that, I think what's exciting about this move is, unlike other format changes, this one is led by a thin layer of content, but the front-end of the content. So we're shooting all our original series, with very few exceptions, in Ultra HD. Our Breaking Bad licenses are all in Ultra HD. Blacklist, all the very front-line shows, and then complementing it with more and more of the catalog. But it's not a show-off of weird, quirky things that look good. It's actually the programming that people are watching.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

Another question for Ted. You talked about your overall content, your ability to gain efficiencies in terms of your procurement of content. Can't tell if whether the competitive landscape is changing at all. Amazon may be getting critical acclaim; it's hard to tell whether they're getting customer acclaim for their shows. Are you seeing anything in the market that suggests that your ability to acquire content is getting easier or harder?

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

On the original side, it's a very competitive market, and we are, fortunately, in a position ourselves as a premier destination for the biggest and best projects. We don't say yes to all of them, and we see them show up at other places. But we do think that we're the first or second go-to for most of the projects that we're looking for.

I think, in terms on the licensing side, the same thing. Which is, as we increase our footprint, our ability to compete in that space really helps being able to get the most high-profile shows. But by doing that, by being more and more confident at earlier and earlier stages. So being able to license that content with much greater confidence. Sometimes a pre-pilot gives us the ability to find those efficiencies.

**Rich Greenfield** - *BTIG Research - Analyst*

But Ted, just to follow on that. Stacking rights has become a real issue for US studios. They're now looking at your requirements for limiting stacking, and also the global buying. Meaning, you don't want to buy things that don't have that global license attached to it. Is that making it harder for you to buy content from some of the big TV producers, as you look out over the course of the next 12 months -- whether it be the Foxes, the Warners, the CBS's? Or is that a non-issue?

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

I think, really, the truth of it is, it doesn't make it harder, because it actually makes it more attractive as the studios streamline their operations. I think they're looking for more streamlined ways of selling their programming efficiently. And on the stacking rights, we're not standing in the way of the network withholding those rights; we're just saying we won't pay full freight if it's not fully exclusive. And so if they want to withhold the right for stacking, they're welcome to do that. It's just, there is a price tag to it. That's some portion of the \$3 billion we're spending this year.

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**Rich Greenfield** - *BTIG Research - Analyst*

But you are, essentially, limiting their downside, but you're also limiting the studios' upside if they agree to sell their content to you. Is that fair?

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

In what way?

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**Rich Greenfield** - *BTIG Research - Analyst*

Well, they don't have the ability to sell it to -- based on the success here, if they're selling it to you, let's just say pre-release, they can't go out and sell it in other markets over time. If they basically limit the stacking, they obviously can't leverage all of their other platforms with those full in-season stackings.

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

That can do it, Rich; they just can't do it for free.

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**Rich Greenfield** - *BTIG Research - Analyst*

Right.

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

Yes.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

A question for Reed. Reed, a couple of months ago, I think, HBO talked about plans to launch this stand-alone streaming service some time in 2015. Any thoughts you have on what kind of impact that could have on your business? And specifically, do think that there is a probability that there would be a broad streaming solution that would come out at a price point lower than Netflix?



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

You know, it's really hard to speculate on what they're going to do on pricing. To the degree that they go really aggressive and match Netflix's price for HBO, then it's extremely disruptive to their current ecosystems, since their prices are higher than that. They've generally given the signal that they're going in softly, in terms of not being too disruptive, using the existing partnerships. That would tend to imply a little bit higher price point. In the Nordics, they did choose, which is the first place that they competed over the top, to be directly on top of us -- about 79 krone for the pricing. So we'll just wait and see.

I think even if they were to match us in pricing, it's just going to be a lot of people subscribing to both. And I think over the years, the last five years, with HBO and Showtime, when Showtime has a great run with *Homeland* and *The Affair*, it increases Showtime subscriptions. It doesn't decrease HBO. And I think we'd see the same with us and HBO. Which is, if they do great work, people will additionally subscribe to them because that cost is pretty small per month -- ours is small per month -- relative to all the other entertainment options. So it's definitely not a zero-sum situation.

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**Rich Greenfield** - *BTIG Research - Analyst*

Both Reed and David, on the next question, as it relates to Dish and Sling TV. MVPD integration in this country has been really a challenge for Netflix. I think you've had a lot more success signing deals outside of the United States. What does the Dish deal mean initially, in terms of the willingness of others in the US? And will we ever see you on the X-1, integrated into the platform?

And then, to the extent that Dish is actually creating subscribers -- this is the part for David -- curious how you get compensated -- or, sorry, how you're compensating Dish if they're able to actually grow your gross additions?

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

I can answer both. We're certainly not going to talk about the financial details with Dish. To the degree Dish has always been a maverick doing some things first, to the degree that they enjoyed great success, like Virgin in the UK, with a platform and it helps the Hopper get more popular -- because it's also an Internet platform -- then I think it is likely that Dish's competitors would want to co-opt that benefit and integrate with us. But right now, everyone is in a watch-and-see; let's see how Dish succeeds with the Hopper hardware, which is what has Netflix. And that's independent of Sling TV. So those are two different things.

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**Rich Greenfield** - *BTIG Research - Analyst*

What do you think of Sling TV? A lot of people have downplayed it. What do you think of the offering and its impact on your business specifically?

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

I don't think we'll see any impact on our business. It's a great start. Charlie Ergen has been a great entrepreneur, and I think he sees the future, that it's Internet-centric. And it may not be the perfect offering today, but it's got, at \$20 a month, very attractive pricing. And he's been an incredible entrepreneur, in terms of starting with something small like the early Dish, and building it into being the Internet MVPD. So it's great for him. It adds some competition in that market. But I don't think it materially changes the desire to have Netflix with our unique and exclusive shows.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

Reed, on the MVPD integrations in Europe, are any of those material enough to have caused some of the upset we saw in this -- to your guidance in the December quarter or in the guide for the March quarter?

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

There are deals that we work on for a long time, so they were all built into the Q4 guidance.

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**Rich Greenfield** - *BTIG Research - Analyst*

Reed, you have not updated us on streaming metrics in a long time. I think Neil Hunt gave the last statistic almost a year ago, in terms of where you are now on a monthly or quarterly global basis. Some color there?

And then just tied to that, we got a lot of questions e-mailed in, in terms of just split -- where it stands today in terms of devices. Given the rollout of better wireless networks, how big is non-in-home usage on tablets and smartphones? And is there any color you could provide on movies versus TV, in terms of absolute amount or absolute volume of streaming?

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

There's been no remarkable changes. TV shows, watching is bigger than movies. That's been a consistent. We've said personal devices, PC, tablet, phone. That varies by markets some, 30%, 40% of viewing. And TV-based viewing being -- a large green screen share being the majority of it. No particular change in those metrics.

In terms of mobile networks, consumers are still, in most countries, quite conservative because of the data caps -- typically two gigabytes or five gigabytes, in terms of watching video on. So we see a lot of tablet and smartphone usage, but almost always on Wi-Fi networks. And then they're careful about how they use the cellular networks because of the caps and the fear of overages.

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**Rich Greenfield** - *BTIG Research - Analyst*

And then, total hours?

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

Total hours continue to grow. We haven't had any super sexy milestone that we've chosen to make an event about, which is when we tend to do those things. Total hours, of course that's going up. But more importantly, median hours has continued to climb in every market as we make the programming better and better.

That's the main thing that we track internally, and it's very exciting to see as devices get simpler to use, as the UI gets more personalized, as the content gets better, that we see it directly reflected in the number of median hours. And that is the closest correlator with retention and word-of-mouth. Because if you're using Netflix a lot, you're much more likely to stay with us and to recommend it to your friends.

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**Rich Greenfield** - *BTIG Research - Analyst*

That must mean you're closing in on two hours per subscriber per day if you've been growing consistently on a median basis?

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

Well, I'll leave that speculation to you. And when we get to great milestones, there's a fair amount of seasonality. We might hit numbers like that in peak times, like holiday period, but not necessarily sustain that over the whole year.

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

I guess that Rich will have a good take on it, whatever that is. Interesting, anyway.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

David, let me bring you back in the conversation. You talk about generating material global profits earlier than expected, but you also talk about a \$1 billion debt raise. Square those comments a little bit. And then, the timing of the debt raise -- when you would expect that and why you would choose debt versus equity?

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

Sure, Mark. I think in terms of profits earlier than expected, it's more that we have clear line of sight, in terms of rolling out the rest of our international expansion. We mentioned that we'd have a couple of years of heavy investment. I think that's going to drive capital needs, which then leads into the conversation around the capital. And we think right now is still a good time to secure long-term, low-cost capital in the debt market. And that's why we've chosen debt. (multiple speakers) with what we've done in the prior three years, actually -- we've done a raise every year.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

I think your points have been that the purpose for the capital raise is largely to fund international expansion. Just want to check that, that's true.

And then secondly, there's a little commentary in here about expanding into China, modestly. I'm not sure what a modest expansion into China is. It sounds like it could be expensive. Are there particular limits you're going to put on that?

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

It will be quite modest. And I can let others speak to that, as well. Basically, the incremental cost to launch in the rest of the globe is smaller, relative to the individual customized launches that we've done to-date in these other territories. So you'll see the level of investment for the countries that we talked about and the countries that we will talk about in 2015, be a little bit higher than the level of investment going forward for, basically, the countries that we haven't yet launched in.

And back to your cash comment, it's really tough to separate the cash. When you have capital in the business, and you use \$1 on content and \$1 to fund international expansion, it's really tough to separate those things. Both of those things right now are requiring cash for Netflix. The international mainly because it reduces \$1 of profit that we would otherwise have. And the content because we've chosen to produce more and more of our own content. And that means we have to fund the production, which has slightly more upfront characteristics than a licensing model, where we would pay a little bit more out over the life of a deal.

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**Rich Greenfield** - *BTIG Research - Analyst*

But you're not in markets like Japan. Or you look at India, you look at South Korea. Those would seem like very expensive markets to enter, from just a content build-up. What's the disconnect there?

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

Let's go back to China, and then we'll visit that. Mark, on China, what we said in the letter is that we're exploring options. We need to get a license; that's not 100% clear that we'll be able to do that. We're figuring that out. And what we said is that if we go, it will be a modest investment. Because we won't have that much content, we're going to be very cautious and feel our way along through that process, if we're able to get that license.

And then, to Rich's question -- yes, there's many other high GDP markets, GDP per capita, like South Korea and Korea and Japan, and those are big investments (technical difficulty) --

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**Rich Greenfield** - *BTIG Research - Analyst*

(technical difficulty) out in, I think, somewhere in the Midwest last month. I'm curious. Are there any key take-aways that we should be thinking about that you learned or that were discussed that would be meaningful to investors?

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

You know, I think the key thing is that everyone sees that Internet TV is really becoming substantial. You saw this with CBS All Access -- 15 years of shows, any episode, a really lean forward move. You see this with ESPN, both heavily investing in WatchESPN. And if you think about it from an ESPN perspective, as long as people are subscribing, whether a third of the time they're on WatchESPN and two-thirds of the time on a linear channel, or the reverse, it's all the same to them. So they're being very forward-leaning and investing in WatchESPN. And by being in the Dish bundle, making sure that they stay accessible by every home in America.

So just across the board you'll see this phenomena that we described a few years ago, of channels becoming apps, people using them on the smartphone and smart TV just as easily and transparently. So the fundamental thesis is getting validated; that's great. And for us, it's both more a competition, and it's more consumers coming in the market, speeding up, because Internet TV is becoming so mainstream.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

Question for David on the streaming content obligations. Those rose to 9.5 billion in the quarter. What levels are you comfortable with, should these continue to rise as the sub-base rises? Is there a natural level at which (technical difficulty) what the appropriate range is for those?

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

There's no absolute number. But when I look at the streaming obligations and the table, and even the ones that are not estimable -- but you can put a range on those, as well, a little bit wider -- I would say that the ratio has been fairly consistent, in terms of it's scaling with our business. So you should expect them to continue to grow, especially as we launch additional international territories.

In the produced content side, the more we license content, the more that will grow in an obligation. The interesting thing about in the production world is, when you produce content and you own it, because you have the discretion to cancel it at any time, it doesn't show up as a content obligation.

So if you look at some of our peers and some of our suppliers in Hollywood, you don't have the same sort of accounting when it comes to an obligation, even though you may say that there's a high probability of finishing or producing a full budget on a particular project. I would say, I think in terms of our revenue and our revenue per obligation, I think it's been trading in a tight band. It's been in a tight band, along with our scale growth.

**Rich Greenfield** - *BTIG Research - Analyst*

Sticking on financials, can we talk about interconnections for a little bit? You signed deals with four of the large customers over the last several months. Curious how those interconnection fees add up. Is this a number where it's now adding up to north of \$10.25 million?

And then related to that, a question for Reed, in terms of do you expect the FCC policy on Internet regulation to actually make the deal that you signed with ISPs actually invalid? Meaning you won't have to pay for interconnection going forward?

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

That would be upside, Rich, that we would not expect, that they would trump existing contracts. But what's been great for Netflix is the general idea of the Internet as a utility, open to all, not for discriminatory use -- has really taken hold.

Of course, the shift we've seen over the last year around perceptions on Title II is amazing to see in just 12 months. We appear to be on the edge of an Acting Title II, and generally codifying the idea that -- at least in the US -- the Internet is a utility for broad social good and wide-open access. And that, over time, if it happens, will significantly insulate us from any accelerating attacks for interconnection. So I imagine we would likely live out the current deals, and that's what's in our plan.

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

And Reed, if I could add -- just on the financials, Rich, we don't talk about the specifics of a deal. But we continue to be very happy with the shift to managing our own CDN. The percentage of our expense that's spent on streaming delivery continues to be quite modest relative to content. Mark and Rich, why don't we hit one more question each, and then we'll wrap up.

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**Mark Mahaney** - *RBC Capital Markets - Analyst*

Let me throw one to Ted then. Ted, just give us an update on the Disney content. I know some Disney content will be streaming into that key Canadian market this year. But going forward, I think, is a very large library of Disney content that will be coming on. Just some color about how big that opportunity is, or how much content that is? And what kind of impact you think that could have, in terms of filling out the [pullet], or whatever, of offerings to families on Netflix?

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

Unique to any other studio, we're excited about the [Pay One] opportunity with Disney. Because those movies are not just movies, they're amazing family content that gets watched over and over again, forms great loyalty with our subscribers, and it's a real trust brand for parents, as well.

So we've really been expanding our relationship with Disney, even in the Pay One window, which I've been fairly dismissive of with other studios, including coming on in Canada this year, and coming into the US next. I think that's going to be a very long-term relationship. It's as global as you get, in terms of (inaudible). We saw the success of Frozen this year all over the planet. It's very consistent with our desire to be more and more global with our programming.

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**Rich Greenfield** - *BTIG Research - Analyst*

Last question from us, although it will be a two-part question. The first piece coming on the DVD front. Obviously, DVD still supplies a lot of profit, David, to your financials. Just curious, given the comments that Outerwall had today that their DVD business seems to be falling pretty precipitously as they look into 2015. How do you think about the DVD business and the sustainability of those profits?

And then, just the final rap question for Reed. You've been so vocal on the Comcast/Time Warner merger and the dangers it poses. Are you increasingly confident that this deal gets blocked?

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

Well, Rich, let me take your question first. On the DVD, I continue to think it's going to have a long tail. If you look, in 2013, we lost 1.2 million of our DVD subscribers. In 2014 we lost 1.1 million, so slightly less. The margin has held steady for two years, if you look at the contribution margin for the DVD business.

So it's going to continue to decline. We don't have any illusions on that. But we think that there's a lot of people -- for a lot of people in rural areas and other cinefiles where the DVD makes sense for them, and at \$8 a month, it's a pretty inexpensive add-on. So we'll just continue to provide great service for those folks that really want it.

And Rich, the key difference with Outerwall is, Outerwall or Redbox is very new-release-centric. So it's vulnerable to the pay-per-view substitution, whereas a broad selection renter like ourself, on a stable business, is much less sensitive to that.

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

Yes, question on Comcast/Time Warner. We've been vocal on the issues that would be presented to US society. If there's one ISP that initially would be 40% of broadband households, and that as DSL fades, pretty quickly would be over 50% of US households, we think that's a tremendous amount of power in one company. We think it would be wise policy for the US to block that merger. We've been consistent on that. Whether it happens or not, we don't really have any direct sense. All we can do is advocate for what we think is great policy and see what happens.

**Rich Greenfield** - *BTIG Research - Analyst*

Do agree with the FCC moving what is broadband definition up to 25 megs? Does that make sense to you?

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

Yes, absolutely. Once you've got an Ultra HD video stream, that's 15 megs just to single screen. And you are going to want video conferencing, you're going to want online learning, you're going want all kinds of different applications -- monitoring of your home, these kinds of things on video. So 25 megs is a kind of baseline for the next five years, as opposed to the past five years.

So with that, let me thank everyone for joining us on this call. And thanks to Rich and Mark for conducting the interview. Thank you all.

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