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NFLX - Q4 2011 NETFLIX, INC. EARNINGS Q&A SESSION CONFERENCE CALL

EVENT DATE/TIME: JANUARY 25, 2012 / 11:00PM GMT

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PRESENTATION

Operator

Good day, everyone, and welcome to the Netflix fourth quarter earnings Q&A session. Today's call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to Ms. Ellie Mertz, Vice President of Finance and Investor Relations. Ma'am, you may begin.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Thank you and good afternoon. Welcome to the Netflix fourth quarter 2011 earnings Q&A session. I am joined here by Reed Hastings, CEO, and David Wells, CFO. We announced our financial results for the fourth quarter at approximately 1 PM Pacific time today. The shareholder letter and the Q4 financial results, and the webcast of this Q&A session are all available at the Company's Investor Relations website at ir.Netflix.com.

As is our standard practice, we will begin the call with questions received via email. Please e-mail your questions to ir@Netflix.com. In the time remaining after email Q&A, we will also open up the lines to take live follow-up questions. The dial-in number is within our investor letter, but let me repeat it now. Please call 760-666-3613, if you would like to get in the queue.

We may make forward-looking statements during this call regarding the Company's future performance. Actual results may differ materially from these statements due to risks and uncertainties related to the business. A detailed discussion of such risks and uncertainties is contained in our filings with the Securities and Exchange Commission. Including our annual report on Form 10-K filed with the Commission on February 18, 2011. A rebroadcast of this Q&A session will be available at the Netflix website after 6.00 PM Pacific time today.

Before moving directly to questions I'd like to turn it over to Reed Hastings for any opening remarks.

Reed Hastings - *Netflix, Inc. - CEO*

Just jump in with the questions, Ellie.

QUESTIONS AND ANSWERS

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

All right, let's move directly to questions. Similar to previous quarters, we've organized the questions by topic as we received them this afternoon. So we're going to start with general content questions. First question. Can you help us better understand the fixed versus variable components in the content deals you are signing? Or how the industry is maybe moving more towards variable mechanisms as content owners better understand digital.

David Wells - *Netflix, Inc. - CFO*

This is David. We have been bidding in an industry that was set up before us by the cable, satellite and pay television world. So all of our deals are fixed. And that reflects the nature of the market that we're competing in. And it's been like that for 10-plus years.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

What is your appetite for bidding against HBO for film studio content in the pay TV window when the pay TV studio deals come up for renewal? Assuming linear and over-the-top rights for those deals are decoupled, would you attempt to acquire both, as you did in the case of DreamWorks?

Reed Hastings - *Netflix, Inc. - CEO*

I don't think it is likely that those rights will be decoupled. So we would be bidding. And that's because HBO, as an example, would certainly want both. So if we are to win the bidding, we have to really be willing to bid for both, as we did in DreamWorks, Relativity. And, yes, we will continue to be an active bidder in that market.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Are you relatively comfortable with your current levels of content? Or is Netflix still in the market for Blockbuster 5 content deals? Do you anticipate that a potential slowdown in content acquisitions will have a meaningful impact on new subscriber acquisitions?

Reed Hastings - *Netflix, Inc. - CEO*

I'm aware of rapidly increasing the amount of money that we spend on content domestically and internationally. The only thing that's slightly different is this quarter we are increasing our spend over a year ago over 100%. So it's more than double one year ago. And that year-over-year increase is declining. But it is still a substantial increase on a year-over-year basis all through this year. And the question is, are we comfortable with the content? We always want to get more content. That's the virtuous cycle which is, as we get more subscribers, we're able to get more content, which then helps us get more subscribers. So we'll continue to invest in improving the service by adding more content for a very long time.

David Wells - *Netflix, Inc. - CFO*

And just to add on to that, it is not just about expanding. It is adding new content. As we discussed in the letter, that increase in expense is somewhat small portion for renewals but actually is for new content to the service. So it's going to be exciting as we add new titles to the service through 2012.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

How should we think about subscription costs as a percent of revenue for 2012 and longer term?

Reed Hastings - *Netflix, Inc. - CEO*

That will vary by market and maturity. What we think about it as, is contribution margin and contribution profit. And as we talked about we did better in Q4 than we expected, and so we're taking up our target for 11% for Q1 for contribution margin in the US. In our different international markets we're still contribution margin negative. And the law says we'll abate in each market as it grows, breaking in the contribution margin positive.

David Wells - *Netflix, Inc. - CFO*

And I think for longer term, there is only two buckets. There's content expense and marketing. And so if we're going to expand our contribution margin, our profitability long term, we would be looking to leverage some of that content launch, as well.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Would Netflix work with virtual MVPD, adding a premium layer of content the way HBO offers content, as here on traditional MVPDs?

David Wells - *Netflix, Inc. - CFO*

I'm not sure what is meant by virtual MVPD. If it means what was reputed that some of the internet firms are working on, which is a national footprint over the top MVPD, I don't think that is going to come into existence. Several large firms have tried to put that package together and backed off. So I think what we'll see is a continuation of the current localized over-your-own-pipe model.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

What's driving the change in tone and/or practice in terms of importance around exclusivity of content?

Reed Hastings - *Netflix, Inc. - CEO*

The more that we bid against other cable networks. So there were many bidders for Mad Men, and there's many bidders for the movies. Those other bidders are cable networks that demand full exclusivity against us. And so we're essentially pushed into bidding exclusive to succeed in this industry. And so what's driving it is that we're in the first leagues of cable network buying now in syndication, and that has always been done exclusively.

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Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Even with Netflix's growing movie streaming library, one of the biggest appeals seems to be TV series episodes. Do you have any plans to offer current season episodes of shows after they air on traditional television instead of waiting for the DVD release? Us Breaking Bad fans are dying to find out what happens next.

Reed Hastings - *Netflix, Inc. - CEO*

Catch-up TV is really a good model for authentication. To the degree that we try to be a substitute for cable networks by, for example, having current day and date content, then we get into a cord-cutting kind of battle that is not really in our interest. So our view is to be complementary by having complete prior season. And that we think authentication TV everywhere interfaces, like Fox is doing, is the way to go for the broadcast networks and cable networks to maximize their opportunity. And we're comfortable with that partitioning because we feel like our segment is very broad and big at a low price point of $7.99. And so that is why we're partitioning ourselves to be prior season. And so, no, we're not bidding on any current season and we don't have any current season.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

How will you measure whether your original programming has a positive ROI and a success? If you believe original programming can start to drive incremental subs, will you commit significantly more capital to this?

Reed Hastings - *Netflix, Inc. - CEO*

HBO spends about one-third or 40% of their budget on original, and the rest on already-produced movie content. So that would be the high water mark. And they do a great job on those originals. We're starting much more modestly with our originals. Some of it we'll judge by how much it gets viewed and how much it costs. Is it an efficient source of programming. And some others in terms of does it attract new subscribers and build the reputation for Netflix. And today it's a modest part of our budget and we'll keep it as a modest part of our budget until we learn more, as we go year by year.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Can you talk through the rationale of making all the episodes of an original series available at the same time, like you're doing with Lilyhammer, instead of spreading them out a bit more?

Reed Hastings - *Netflix, Inc. - CEO*

Yes. Netflix's brand for TV shows is really about binge viewing. It is to accommodate, to just get hooked and watch episode after episode. It's addictive, it's exciting, it's different. And our release strategy for original content emphasizes that brand strength which is to be able to get hooked and pour through those episodes rather than get strung out. And we're not particularly focused on a single show for driving retention. It is the expectation of more and more shows that really drives retention.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Final question on originals. Can you please talk about how accounting for these series will work and under what scenarios a write-down is possible?

David Wells - *Netflix, Inc. - CFO*

The accounting for them will be straight line. We always monitor the content in terms of the engagement or hours viewed. And unless proven differently in the usage and watch patterns, it will be straight line. Now, I will point out, as Reed discussed, that for 2012 it is a very modest portion of our budget. So I really think this is more of an issue of 2013 and going forward unless you see us announce some other large original that's going to come out this year.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Do exclusive contracts only differentiate you from other web only players or also the TV everywhere players? For example, could Xfinity show some of the TV catalog that is exclusive to you, either via the set-top box or Xfinity apps? Or the contracts like Epix where authenticated paid TV subscribers can watch the movies online?

Reed Hastings - *Netflix, Inc. - CEO*

It varies. We have different types of exclusivity in different contracts. In the strongest form it's like DreamWorks or Relativity. And then it is in all forms other than DVD. In some it's just exclusive in the Internet SVOD, some in all SVOD, with different carve-outs. So there is quite a mix there.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Given that your content purchase deals are based on assumptions of subscribers, did you experience with the price increase and subsequent slowdown in net ads that you have spent more on content than you would have, given all the information you have now? In other words, do you feel like you're in an over-bought position now?

Reed Hastings - *Netflix, Inc. - CEO*

We feel great about the content we've got. We don't feel great about the profit stream we have for this quarter. And the impact of the relatively lower subscribers than we thought we would be at is not showing up in the quality of our service, which has continued to be excellent. And for the content to grow it shows up in our profit stream. We hope to mitigate that, obviously, as we grow the subscriber base over this year, and return back to break-even and continued rapid international expansion.

David Wells - *Netflix, Inc. - CFO*

And as Reed said, we've been really pleased with the engagement of the content that we added through Q4. So I don't think that we've bought a group of content or a block of titles that we're unhappy with.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

What is the balance of purchase commitments for content as of 12/31/2011?

Reed Hastings - *Netflix, Inc. - CEO*

I think this is referring to the contractual obligations footnote. And they're probably asking, before we filed the K. It was $3.5 billion at the end of Q3. That goes up to $3.9 billion at the end of this quarter, Q4, that we're reporting on.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

What percentage of streaming is occurring on TVs versus mobile or smartphones versus tablets versus PC/Macs?

Reed Hastings - *Netflix, Inc. - CEO*

We don't break it out publicly. All of those platforms are very successful for us and an important part of the mix.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

If the goal of Netflix is to provide consumers with a convenient place to watch TV shows and movies, but subscription can only allow for a partial library of what a consumer wants to view, why doesn't it make sense to add the ability to rent a la carte new release films? In other words, what is wrong with being everything to everyone and providing a one-stop shop for digital movies through Netflix?

Reed Hastings - *Netflix, Inc. - CEO*

I don't think there is a lot of brand strength in being, to use the quote, everything for everyone. You gain profit and brand strength from being something important and precise. And we believe that unlimited for a low fee in the US, $7.99 a month, is the core of our brand proposition. And that if we were to add pay-per-view, it would be a negative, it would confuse the brand. And there is a number of providers -- Walmart's VUDU, Apple's iTunes, Amazon Unbox, Best Buy Cinema Now, Blockbuster -- the list just goes on and on of providers who already offer pay-per-view. And we have no way to do it better, that we know of.

So what we're focused on is instead working with all of those partners and keeping the clarity of our brand. So our strategy is to -- essentially you can think of it like building digital -- is be in every platform and get along with everyone. And we believe that there's a large enough market at an $8 unlimited subscription to have us grow very large. So, to some degree it is a niche strategy, but it's a very large niche that we think we can lead. And so that is why our focus is exclusively on unlimited. And we're not at all, nor have we ever been, interested in pay-per-view.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

What does content under-spending means as it relates to the margin impact on streaming in the fourth quarter 2011?

David Wells - *Netflix, Inc. - CFO*

It's a small under-spend and it is related to contract dates shifting out by a month or so. So it's a pretty small number. And we always have contracts that are moving around, up, backward, in terms of when the window availability starts, and that is what it was related to.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Let's move to questions about international. I know it's early but what have you seen so far from international? Is there a case to be made one way or another about the relative profitability long term of a US versus a non-US subscriber?

Reed Hastings - *Netflix, Inc. - CEO*

I'll take it. The profitability of a subscriber is based upon the barriers, competitive barriers on a relative scale. So in any market in which we have very strong scale advantage, we'll have higher profitability. In any market where, for example, there is three roughly equal sized firms, then we would have less profitability. So it's not so much US versus non-US. It is relative scale in each of the markets. And that's part of why we're investing so aggressively to be early and to lead this market in as many markets as we can.

David Wells - *Netflix, Inc. - CFO*

The only thing I would add to that is it is also about relative consumer offerings in that market, or competition. So between the scale and the available consumer offerings you'd see those two things.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

How do you determine that your initial launch offering has the right ingredients for a successful launch and positive word of mouth?

Reed Hastings - *Netflix, Inc. - CEO*

We focus on research in terms of consumer preferences, look at Nielsen type data in terms of what people are viewing. We do in-market research. And all of that informs our intuition. Then we launch. And then we start to really learn what people are viewing, what they like in terms of, say, subtitles, what they like in terms of how much of is high-def, how important is that, what platforms. And there is considerable variation between markets. So think of it as we do a bunch of effort up-front but it doesn't matter much. It just gets us started. And then we rapidly iterate and learn as to what are the important preferences in each market.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Looking at Latin America, there are some key differences in terms of income levels and broadband penetration rates. Is there anything about Latin America that indicates the region may achieve profitability faster or slower than a region like Canada? How should we think about the cost of content deals in Latin America compared to the US and Canada?

David Wells - *Netflix, Inc. - CFO*

Latin America, you can infer from our discussion in the earnings letter, both from our net additions in this Q4 for international versus last year is growing slower than Canada did in its first quarter launch. I would say that we're building a new brand in Latin America where we had much more of a US halo brand effect in Canada. And device penetration in Canada was higher than it is in Latin America. Those two things are turning out to be important. So I think Latin America is a good, and prospectively a great, market for us going forward, but it does look like it is going to be on a path slower to profitability than Canada. And then the second part of your question, can you ask that one more time?

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

How do you think about content deals and the cost in Latin America relative to Canada and the US?

David Wells - *Netflix, Inc. - CFO*

Sure. So content pricing is related to the value that the owner of that content, and the producer of that content, can monetize in each different market. It is more specific than even Latin America. It is within a country market. And so, relative to Canada, it's hard to answer that question in terms of the content. It would be less if that content owner has fewer monetization options in, say, a Brazil or Mexico than they do in Canada.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Given the situation you're describing in Latin America, is it going to take you longer than you have anticipated to reach profitability in that market?

Reed Hastings - *Netflix, Inc. - CEO*

It's early to say, but on balance I would guess yes, that it will take us longer than two years. So we're working hard on all of our payment issues and sub titling issues, rapidly improving them, and then we'll be able to see what is the underlying growth trajectory. So it is not out of the question but I would say the odds are it will take longer than two years. And I'll point out that the two years is a bit of a aspirational, arbitrary benchmark. If you look at DIRECTV, it took them a number of years to gain their market position and now they have an extremely valuable franchise. So mostly the two-year goal is a great internal goal because we want to turn around that money and invest in the next market. But the fundamental will we get a return on it, we feel very strongly about with the growing economies in Latin America and our strong relative competitive position, that we can build a very valuable franchise in Latin America.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

In examining your Latin American product, would you say that most of the streaming activity is in the Televisa Novelas or Hollywood programming out of the studio system? Also, what are your feelings about how the Latin American streaming product is priced versus the competition? And do you think any pricing tweaks are necessary?

Reed Hastings - *Netflix, Inc. - CEO*

Definitely pricing is not an issue. We're very aggressively priced. For example, 99 pesos in Mexico. Most of the content viewing is Hollywood content. And that's how we've programmed them. And then we complement that with Tele Novelas.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

When negotiating with the studios, how does the prevalence of piracy in Latin America impact the deals in terms of pricing and/or release schedules?

David Wells - *Netflix, Inc. - CFO*

That gets back to my earlier comment about the available monetization channels that the content owner has. And if piracy depresses those, then the cost of that content is lower because their ability to monetize the content in market is lower.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Why do you dismiss Love Films so quickly as DVD only? Let me take this one.

Historically Love Films has been predominantly focused on DVD. Streaming is really something that they're only in the early stage of. Whereas we have been focused on streaming for five years now. And so if you look at the services, we're better, faster and easier to use in the UK. So we expect there will likely continue to be successful in the DVD by mail and the hybrid segment of the market. Which, for us domestically, is about 40%. If you just look at how they're offering the service today, they came out with a strong streaming only offering around the time of our launch, and yet it is still very difficult to find on their website. So we'll continue to monitor them. But I think we have a leg up in terms of our streaming experience. Now that you are operating in four distinct regions -- US, Canada, Latin America and UK Islands -- is there a need to favor one specific region over another in terms of allocating the content spend?

Reed Hastings - *Netflix, Inc. - CEO*

No, there is no such need.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Why did international free subs decline quarter-over-quarter? Is this normal seasonality?

David Wells - *Netflix, Inc. - CFO*

I think the reference is in terms of international frees, if you take the total.

Reed Hastings - *Netflix, Inc. - CEO*

That would be Latin. We launched Latin America mid-September. And so there was a big burst of trial subs, and there was no market that we launched in December.

David Wells - *Netflix, Inc. - CFO*

Right. So seasonal with the launch.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Do you expect international quarterly losses to begin to decline in the second quarter of 2012?

David Wells - *Netflix, Inc. - CFO*

What we said in the letter was that losses would moderate. So, yes, I think that that implies that they would go down in moderation from Q1 to Q2.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

I think it's safe to say that our losses will obviously be dependent on subscriber growth and the revenue that we generate from that growth. Let's move to questions about DVD. If the DVD business continues to decline, would you look to consolidate warehouses? How do you expect closing of post offices to impact shipment time?

Reed Hastings - *Netflix, Inc. - CEO*

The closing of post offices has been put off, probably post the election. So I don't see a big threat on that this year. And then in terms of closing our distribution centers, there's no practical savings to closing those. Most of the costs are the disks and the postage. Very little of it is our own processing centers. So it is just not material.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

How do you think consumers will react to a 56-day new release window? Do you expect that to drive more consumers away from DVD subscription?

David Wells - *Netflix, Inc. - CFO*

Our DVD consumers, including hybrid and DVD only, continue to be weighted towards catalog. It is less than 30% in terms of the shipment mix that are new release oriented. When we went to 28-day, we didn't see a big shift because, again, that mix was about the same then. And it's actually gone slightly down. It hasn't gone slightly up, as you might surmise from more concentration to DVD subscribers.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Will you be adding video games or 3D movies to your product offering, especially if subscribers are willing to pay a premium like they do for Blu-ray discs?

Reed Hastings - *Netflix, Inc. - CEO*

3D movies we already have. We have a lot of Blu-ray that's on 3D. And on streaming, that is definitely something we can do, we will be looking at. In terms of video games we have no plans to enter video games.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Looking at your Q1 guidance and utilizing the mid points, it seems that your guidance is suggesting that a DVD subscriber is contributing about 6 times more to profits than a streaming subscriber. Or around $15 for a DVD customer, but only $2.50 for a streaming customer. Do you still feel it is a wise strategy to push customers towards the streaming service? And if so, what effects do you anticipate on long-term margins?

Reed Hastings - *Netflix, Inc. - CEO*

The analysis is well-intentioned, I'm sure, but it is not looking at the marginal cost and the marginal increment, which is the important one. So, a marginal streaming subscriber is almost pure contribution margin. There is a little bit for credit card, CS, and CD end fees, but it is pretty modest. A marginal DVD subscriber has a number of variable costs -- the postage and DVD fees, in particular. So, actually it is the opposite, which is the profitability of a new streaming subscriber, the contribution margin is almost twice what it is for a DVD subscriber. So that is the way we think about it. We would like to have someone use both services because obviously that is both more revenue and more profit. But if they were only going to use one, we'd much prefer them use the streaming service.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Why the reduced expectations for Q1 DVD contribution profit margin? Are content costs going up or do you expect to market the service more?

Reed Hastings - *Netflix, Inc. - CEO*

The reduced margin is related to the reduced revenue that we discussed in the letter. It's not going down too much, other than the fact that there is a seasonal increase in usage in the DVD business. So Q4 to Q1 we usually see a margin reduction in the DVD business.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

In terms of retention, initiatives are being done in the DVD segment. Will Netflix be marketing the DVD service in 2012?

Reed Hastings - *Netflix, Inc. - CEO*

There are no specific retention efforts, and we don't plan on marketing the DVD service. Our primary goal is to keep it stable, very high functioning, to keep our operational metrics in terms of top-of-queue fulfillment in terms of one-day turnaround very, very high. And not to otherwise disturb it. Keep it running very well.

David Wells - *Netflix, Inc. - CFO*

When we've tested DVD plans and putting more emphasis on DVD plans, there hasn't been a great take rate. I think we get that question a lot. And we have looked at it through A/B testing and there is not a large consumer adoption of those plans.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Moving to questions about our consolidated results and outlook. With the stated goal of returning to profitability before launching new markets, is it fair to expect that you'll basically be matching the rollout of new markets to profitability for the foreseeable future? Meaning that once margins go above break-even, new markets will be launched to bring them back down until that profitability is reached again, and the cycle repeated until you reach a global or near global offering?

Reed Hastings - *Netflix, Inc. - CEO*

Yes. That's a very articulate description.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Let's move to questions about competition. Looking at competition for streaming rights domestically, we agree the breadth of content on Hulu and Amazon does not appear to match Netflix today. But you see that changing? Are you seeing them or potentially other players bid more aggressively for broader rights analogous to yours? In other words, is the bidding activity for streaming rights picking up?

Reed Hastings - *Netflix, Inc. - CEO*

There is very little market just for streaming rights. It is mostly generalized exploitation rights. And so actually Hulu plus an Amazon are quite small bidders compared to the cable networks that we bid against. So no material change from them.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

You talk about Amazon getting into the standalone subscription market at a lower price. Would you expect them to do that with their current offerings? Or would they need to acquire more content and more aggressive movies?

Reed Hastings - *Netflix, Inc. - CEO*

I'm not sure on their content strategy. It depends on how much they want to spend.

David Wells - *Netflix, Inc. - CFO*

To date, they've taken a measured approach, but we'll see.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

What do you think the implications of the future Apple TV that is reported in the works might mean for your business' strategy?

Reed Hastings - *Netflix, Inc. - CEO*

I don't have any insight on an Apple TV. But there is a small three-inch by three-inch box called Apple TV that Apple invited us on about two years ago. And it has been very successful for us. We've just updated that application, making it even better, adding a great Netflix for kids interface on it. It's now throughout Latin America and we expanded the agreement with Apple for the UK and Ireland. So we're working really well with the current and existing Apple TV.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Moving to questions on the financials and other metrics. In early January, Netflix announced that it streamed 2 billion hours of content in Q4. Can you explain why hours streamed is a relevant metric? If subscribers stream more hours, what impact does this have on Netflix's subscription costs? Will you be reporting hours streamed on a regular basis?

Reed Hastings - *Netflix, Inc. - CEO*

I would liken that to, in 2007 when we announced the milestone 1 billionth DVD shipment. It's a measure of an engagement and scale in terms of the widespread adoption of our service and use of our service. So I wouldn't expect us to regularly update that on a quarterly basis, but on a milestone basis. It is a great milestone for us to have hit. And, like I said, shows widespread adoption and usage of our service.

David Wells - *Netflix, Inc. - CFO*

And then there's very little margin impact from more usage. It is only in the CDM fees is the only place where that exists.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Could you update us on the percentage of subscribers who have both DVD and streaming?

I can take this. At the end of the year, we had about 8.4 million subscribers who were on both of the services. So about 40% of our total streaming subscribers domestically.

Reed Hastings - *Netflix, Inc. - CEO*

And it is continuing to fall.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Any impact to costs from the Durbin Amendment?

I can take this, as well. Durbin Amendment, as related to our business, basically caps the interchange fee charged to merchants when transacting with debit cards. As can be expected, we have a high percentage of our transactions that are, indeed, conducted through debit cards. And so we will see a decrease in the percent of revenue paid towards credit card fees this year. It's incorporated into our guidance.

David Wells - *Netflix, Inc. - CFO*

It is buried in the cost of revenues, though. Streaming content expenses obviously are much bigger than our transaction fees on debit and credit cards.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Going forward with international mix. What are assumptions on blended tax rate for Q1 and all of 2012?

David Wells - *Netflix, Inc. - CFO*

Q1 will be 39%. We continue to be pretty close to a full tax rate payer. It is unknown whether the R&D tax credit will be renewed this year. My guess, will be punted through until the end of the election. And if it behaves similarly to 2010, if it is, it's adopted, they will probably make it retroactive and we might have a similar tax pattern to 2010. Which means that we'll have 38%, 39%, and then there will be a low rate catch-up in Q4.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Let's move to questions on Facebook. How has the Facebook integration impacted subscriber growth in Canada and Latin America?

Reed Hastings - *Netflix, Inc. - CEO*

There is no direct measurement that we're able to do on our success in all of our international markets, how much of that is due to Facebook and social integration. So instead what we look at is engagement. How do we get people to enjoy it more, use it more, click on more of the stories, watch movies from the social rows. So our driving and focus in each of our updates is just increasing engagement. And that's been going very well. And we're excited about the possibilities of social TV as we continue to figure out how to evolve it and improve it.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Is there an update on when you expect the app to be available to US members?

Reed Hastings - *Netflix, Inc. - CEO*

I think we covered that in the investor letter under the BPPA section.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

The international tests, do they provide meaningful data in terms of the average boost to new subs, increased fees, viewing from existing subs, et cetera?

Reed Hastings - *Netflix, Inc. - CEO*

I think we covered that, which is we don't have a clean A/B, so we can't tell if the success is because of our brilliant advertising or because of our Facebook integration.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Here's the questions on devices. Apple sold 15 million iPads last quarter. But in the past you have said you don't believe that tablets are a subscriber acquisition channel for Netflix streaming. Do you think that the faster, out-of-home bandwidth speeds would possibly convert tablets into a bigger subscription acquisition channel?

Reed Hastings - *Netflix, Inc. - CEO*

Not particularly. Tablets are very successful and people are watching Netflix on lots of tablets. It doesn't make it an acquisition vehicle. It is a great consumption vehicle. And tablets, as opposed to phones, tend to be Wi-Fi. And tend to be used then without data caps. Whereas phones tend to be used on mobile plans, cellular plans, that have data caps, at least in the US generally. So we're very bullish on tablets, we're investing heavily in it. We've updated our iPad interface and made it much better, and we're continuing to invest in that. So it is a key part of our strategy.

David Wells - *Netflix, Inc. - CFO*

We said earlier that we don't comment on the relative usage across devices. But one of the reasons we're investing in tablets is because we do see people enjoying a lot more of their viewing on tablets relative to the PC.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Have you seen any impact from Smart TV sales during the quarter?

Reed Hastings - *Netflix, Inc. - CEO*

Yes, absolutely. Smart TV is one of our fastest-growing device categories. It's just beginning, obviously. But as consumers buy and set up internet TVs, they certainly want to be able to use Netflix. And then many of them, we've got a great red Netflix button right on the remote control. So that makes it very easy. The long-term trend for us on Smart TV is very exciting and positive.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

One question on the Q4 financing. In hindsight, do you wish you waited on the secondary, given the quarter and guide for Q1 was better than original guidance? Why did you not just wait until Q1 to do the raise?

Reed Hastings - *Netflix, Inc. - CEO*

It's always fun to pick stock prices in hindsight. You could have great returns when you do that.

David Wells - *Netflix, Inc. - CFO*

Yes, I would say that hindsight is easy. Given the same facts, I would make the same decision. The relative dilution is unfortunate, we'll work a little harder, but otherwise we're in a much stronger position.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Great. That's the end of the submitted email questions. At this time I'll turn it over to our operator and we'll begin taking live follow-up call-in questions.

Operator

(Operator Instructions) Rich Greenfield from BTIG.

Rich Greenfield - *BTIG - Analyst*

A couple of followups. One. Reed, when you initially were going to separate the two plans with Quickster, you had talked about investing in the DVD business. And that's part of the reason you were doing it, was to invest in that business because you thought it had a long life. It seemed like the comment you made earlier made it seem like the DVD business is something you're not going to put a whole lot more emphasis on from an investment standpoint. Does this all relate back to the fact that the DVD business is actually now declining? Do you expect standalone DVD subs to be down each of the quarters throughout 2012?

Reed Hastings - *Netflix, Inc. - CEO*

Yes, Rich, we expect DVD subscribers to decline steadily every quarter forever.

Rich Greenfield - *BTIG - Analyst*

Because the standalone subscribers, I think, actually were up in Q4. And so now you actually think that, now that the shift from hybrid to standalone DVD has subsided, the net effect will be standalone DVD only subscribers going down quarter after quarter?

Reed Hastings - *Netflix, Inc. - CEO*

We don't think about it as standalone versus hybrids. There's just DVD subscriptions and DVD subscriptions. Which are 11 million at the end of last year, are going to decline steadily, essentially forever.

Rich Greenfield - *BTIG - Analyst*

And then, if I could, just one last question. On viewership, the 2 billion hours I think was a real surprise to most people in the industry. And I think one of the things that is talked a lot about by investors is that the people say the content is not that great, there isn't that much to watch. And yet when you see 2 billion hours, or people watching an hour a day, there seems to be a real disconnect between what people are doing with Netflix, or even what some of the other media executives in the industry think people are doing on Netflix, and what they are actually doing. What do you think the biggest reason for that disconnect is?

Reed Hastings - *Netflix, Inc. - CEO*

The average American household watches eight hours of TV a day. And the average investor does not watch eight hours of TV a day. So when one looks at one's own personal behavior, there is a big disconnect, I would say, relative to median or typical Americans. Which is, at over 20 million subscribers, is most of our market. And so if there is a disconnect that might be the reason why.

Rich Greenfield - *BTIG - Analyst*

Thank you.

Operator

Jason Helfstein from Oppenheimer.

Jason Helfstein - *Oppenheimer & Co. - Analyst*

Two questions. First, not sure if you want to comment. In the last filing, you guys talked about expecting an EPS loss for the year, that was around your offering. I'm wondering how the near-term results and your outlook for the first quarter affect that outlook, and if that's still a current number. And secondly, can you just update us what the share count was at the end of the quarter?

Reed Hastings - *Netflix, Inc. - CEO*

On the first part, I'll refer you to the investor letter which addresses that precisely. And then the share count?

David Wells - *Netflix, Inc. - CFO*

55.4 million was the diluted share count at the end of the quarter.

Reed Hastings - *Netflix, Inc. - CEO*

And that's in the letter, the investor letter, also.

David Wells - *Netflix, Inc. - CFO*

Yes, it's on the first page of the letter.

Jason Helfstein - *Oppenheimer & Co. - Analyst*

Thank you.

Operator

Anthony Diclemente from Barclays Capital.

Anthony Diclemente - *Barclays Capital - Analyst*

On the Warner Home entertainment moving its window to 56 days from 28, you'd mentioned in the letter that that improves your relationship with Warner. And I know that was relevant to the DVD side. But there's some investors out there wondering if there is a possibility that you licensed more of those TV studios' content going forward. I just wonder, is your relationship with Time Warner, and Warner Bros. improved such that it is any more likely incrementally that you can secure Warner Bros. TV content from here? And does the expanded window relate to that in any way?

Reed Hastings - *Netflix, Inc. - CEO*

Just to correct you, I don't believe that we said it improved the relationship.

Anthony Diclemente - *Barclays Capital - Analyst*

To maintain a direct relationship with Warner.

Reed Hastings - *Netflix, Inc. - CEO*

Yes, as opposed to going to Walmart and buying the DVD sideways. So that's what that is a reference to. So it's a perfectly healthy, respectful relationship. And when we're the top bidder and we make them more money than anybody else, we get the content. And when we're not the top bidder, we don't get the content. But we don't do them favors, they don't do us favors. But there is trust and respect. And when there is an overlap, that we're able to do good business.

Anthony Diclemente - *Barclays Capital - Analyst*

Okay. Thanks.

Operator

Mark Mahaney from Citi.

Mark Mahaney - *Citigroup - Analyst*

The comment about under-spending in marketing in Q4, could you just provide a little more color around that? Was there newfound efficiencies or was that just a timing issue?

David Wells - *Netflix, Inc. - CFO*

It wasn't timing, Mark. This is David. It was related to the fact that we had to make some estimates on Netflix button payments for CE manufacturers. And our estimates were too high.

Operator

Thank you. Mike Olson, Piper Jaffray.

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

You said in the letter that you won't add new geographies until you return to profitability. Is that global profitability on a quarterly basis or full year?

David Wells - *Netflix, Inc. - CFO*

Quarterly.

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

Okay. That answers the question. Thank you.

Operator

Scott Devitt, Morgan Stanley.

Scott Devitt - *Morgan Stanley - Analyst*

I have two. First, the DVD business has inherent upsell capability given the multi-disk and the Blu-ray premium, as well. And so for streaming it is less clear. You've talked historically about the possibility of things like family plans. And I'm just wondering if you can speak to those opportunities to the extent that you think they do exist, and whether you think the $7.99 is the right long-term price for the US streaming product.

Reed Hastings - *Netflix, Inc. - CEO*

I think $7.99 is the right price for streaming. We feel great about that price. We're succeeding at that price. We have growing contribution margin, growing market share at that price. So we don't have any plans to change that. We will be adding various kinds of multi-account options over the year that our product officer Neil Hunt has talked about. And those are aimed at providing a better experience. So that, for example, not all of your kids' content shows up for you, and not all of your content shows up on your kids' accounts. So we'll continue to include the experience in that way.

Scott Devitt - *Morgan Stanley - Analyst*

And, separately, you've also mentioned that the streaming business has a higher incremental contribution margin, profit. And so I understand it's early, and subscribers are a key ingredient, I suppose, to the margin profile of the stream business over time. But how do you think about the margin profile of that business given that, on one hand, your retail price is lower than premium TV providers? On the other hand, if you take the premium TV providers such as HBO, and even if you gross their business up for the MSO rev share, they have operating margins in the mid-20%s.

Reed Hastings - *Netflix, Inc. - CEO*

I agree with your facts, Scott, but I'm not sure what the question was.

Scott Devitt - *Morgan Stanley - Analyst*

The question is, as you position the streaming business, and you're thinking about it, understanding that it very early, what do you think the margin profile of the domestic streaming business is?

Reed Hastings - *Netflix, Inc. - CEO*

Let's see. So HBO gets round numbers, around $7 or $8 per sub, from the MSOs. We hope that we can have a much larger subscriber base than them. And that will allow us to spend even more on content to have an even better service. Then you've got obviously the on-demand aspect of Netflix and all of the work that we do to make it personalized and even more useful. So we should be able to, in the long term, have an even better margin position than HBO. But it really depends on a relative scale. So if we're twice as large as the nearest competitor, it would tend to lead to large margins. If it is neck and neck of us and HBO in terms of subscriber size then there would be tighter margins for both of us.

Scott Devitt - *Morgan Stanley - Analyst*

Thank you.

David Wells - *Netflix, Inc. - CFO*

And if there is more substitution between those two rather than complement.

Operator

Nat Schindler, Banc of America/Merrill Lynch.

Nat Schindler - *BofA Merrill Lynch - Analyst*

In the past you have said that you have seen, at least initially, that there was a shorter duration or lighter connection with streaming subscribers leading to a (inaudible) versus streaming subscribers on a same cohort basis. Are you continuing to see this? And where do you think streaming churn will end up relative to your historical near 4%?

Reed Hastings - *Netflix, Inc. - CEO*

Nat, you're on a mobile phone and it was cutting out while you spoke. The question I got was long-term churn. It's not something that we really focus on. We make it easy for subscribers to get in and get out. And one of the aspects of the membership change that we referred to, definitional change, for example, is that if we go to your credit card and the charge doesn't go through, you're essentially instantly cancelled for membership purposes. You no longer count as a paid member. And then when that credit card clears you become a member again. And so you could imagine that if you treat it that way, that wreaks havoc with, or makes churn numbers not really that sensible. So that's some of the reasons that we have really been focussing on net additions and total subscriber growth and not churn.

David Wells - *Netflix, Inc. - CFO*

I'd say the other thing I would add to that is, just like the DVD business, our subscribers get higher in retention the longer they are with us. So I think you're referring that to the relative statements we made about streaming retention, early subscribers versus streaming retention, hybrid or DVD subscribers. But that retention does get better the longer the sub remains with us, just like it has before. So the more the base, the subscriber base, ages, the better our retention overall.

Nat Schindler - *BofA Merrill Lynch - Analyst*

David, just a quick follow-up. Does that equal out to very similar on DVD versus streaming on a same cohort basis in time? Age of subscriber.

David Wells - *Netflix, Inc. - CFO*

So, if the retention pattern starts a little bit lower, on the retention pattern, it's not going to equal. I see what you're asking. You're asking if someone who has been with us for a year, streaming subscriber, is equivalent to someone who has been with us for a year on hybrid or DVD. And it is roughly in line.

Nat Schindler - *BofA Merrill Lynch - Analyst*

Okay. Thank you.

Operator

Doug Anmuth, JPMorgan.

Douglas Anmuth - *JPMorgan - Analyst*

A couple things. So first, just on the 1Q streaming guidance, can you just clarify? You mentioned that 200,000 fewer domestic streaming subs potentially in 1Q based on the change on payment hold. So are you suggesting that guidance would be 200,000 higher if it weren't for that change? And then also, any commentary what you' expect for streaming sub growth in 2012?

Reed Hastings - *Netflix, Inc. - CEO*

Correct on your first one. And nothing more than the letter on the second.

Douglas Anmuth - *JPMorgan - Analyst*

Okay. And if I could just follow up with one more. Can you just clarify why there is no deleverage in the DVD business if you have to continue to operate the warehouses around the country?

Reed Hastings - *Netflix, Inc. - CEO*

Because the warehouses are -- I shouldn't say no deleverage -- but the warehouses are such a tiny percent of the total cost. And most of the equipment, or a lot of it, is depreciated, that there is only very modest deleveraging.

David Wells - *Netflix, Inc. - CFO*

So if you think about the DVD cost, postage and the cost of the content are more variable, and those are the bigger pieces than the costs of fulfillment. That is one of the reasons we see that fulfillment as a percent of revenue is going down.

Douglas Anmuth - *JPMorgan - Analyst*

Okay. Thank you.

Operator

Andy Hargreaves, Pacific Crest.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

Can you give us a sense for how you think about the mix of marketing versus content spend as you're entering new markets?

David Wells - *Netflix, Inc. - CFO*

Andy, I can't really help you on that for competitive reasons. We enter big on both to create both a lot of brand awareness and to have it be a good experience. So each country we're learning more and more. Or each market we're learning more and more. We started in Canada. We adjusted that mix a little bit for family. Adjusted it again for UK and Ireland. And we're continuing to improve in terms of that mix. But we view it as a good proprietary advantage.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

And then just a model question. Is there early conversion on the TCV convert so that you would have to count those shares in the diluted share count at the current price?

David Wells - *Netflix, Inc. - CFO*

The forced conversion price is $111.54, and it has to be at a sustained level for a number of days. So it's possible, but the conditions are somewhat public.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

And when does it become eligible for that, David?

David Wells - *Netflix, Inc. - CFO*

In six months.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

Six months from issuance -- mid-November.

David Wells - *Netflix, Inc. - CFO*

Right.

Andy Hargreaves - *Pacific Crest Securities - Analyst*

Thank you.

Operator

John Blackledge, Credit Suisse.

John Blackledge - *Credit Suisse - Analyst*

Couple questions. The 4Q '11 subs, particularly the net unique sub adds are a little better than what you guided to. Just wondering what drove that. Was December better? And then if you can give us a sense of what the net unique sub losses and/or additions by month were in the fourth quarter that would be helpful. Thank you.

THOMSON REUTERS

Reed Hastings - *Netflix, Inc. - CEO*

John, it was better, as we said in the letter. That October and November matched what we had expected, and December was stronger. And that was a combination of more gross adds around the holiday period, our integration into all of the devices. And fewer cancels than we had expected.

John Blackledge - *Credit Suisse - Analyst*

Great. Thank you.

Ellie Mertz - *Netflix, Inc. - VP Finance & Investor Relations*

Okay. That's going to be the last question for today. We would like to thank everyone for your time and look forward to speaking with you next quarter.

Reed Hastings - *Netflix, Inc. - CEO*

And I feel obliged, since I just got back from Sundance, to give you two movie recommendations, to end the call on a light note. Both The Surrogate and Beast of the Southern Wild hopefully will get picked up and distributed and everyone will be able to see them. They're fantastic movies and I'll try to make sure they're on Netflix for all of you, too. Thank you, everyone.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes our program for today. You may all disconnect and have a wonderful day.
