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# EDITED TRANSCRIPT

NFLX - Q2 2015 Netflix Inc Earnings Call

EVENT DATE/TIME: JULY 15, 2015 / 8:30PM GMT



## 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 - Analyst*

## PRESENTATION

**David Wells** - *Netflix, Inc. - CFO*

Hi. Welcome to the Q2 2015 Netflix earnings interview. I'm David Wells, CFO. Joining me today on the Company side is Reed Hastings, our CEO, and Ted Sarandos, our Chief Content Officer.

Interviewing us today is Mark Mahaney from RBC, and subbing in for Michael Nathanson who couldn't make today is Rich Greenfield, veteran interviewer. So we welcome him back.

Just a reminder that we will be making forward-looking statements. Actual results may vary.

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## QUESTIONS AND ANSWERS

**David Wells** - *Netflix, Inc. - CFO*

I think it's over to Mark with our first question.

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

Great, thanks David. This was an upside quarter. Let me go through -- we will go through some of those factors. I'd like to ask you about them. You did 900,000 net adds in the US. You had guided for 600,000. That's an unusual level of upside. What drove it, and how sustainable is it?

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**David Wells** - *Netflix, Inc. - CFO*

We think it's content. It's the building momentum of our original content. It's hard to isolate it specifically to that, but given that we've grown at about 600,000 subscribers for the past two years. And this year we're up to 900,000 in Q2, which seasonally is usually a weak quarter for us relative to Q1 and Q3 and Q4. We just had a really strong slate, and I think it showed through in our results, both US and international.

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

And then Reed, as a follow-up, you've long talked about 60 million to 90 million potential subs in the US market. Looking at these results and looking what's implied in the guidance for next quarter, it looks like you're on track to add more subs this year in the US than last year. Do you feel better about the upper end of that range? Any comment, any updated thinking on that long-term range?



**Reed Hastings** - *Netflix, Inc. - CEO*

No, Mark. We've been tracking at 5 million to 6 million net adds for several years now, and our hope is that we could just keep that going, 5 million to 6 million every year for a number of years. And then we will be solidly in that range, which will feel great.

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

Reed, when you look at the price that you offer, the actual Netflix price of \$9, when you think about the fact that the average subscriber is now using Netflix over two hours a day, it just seems like that price point doesn't really fit with the amount of usage. How do you think about the elasticity of your price point now?

Do you either start raising price more often, or do you simply let people increase their price as they take either the 4K plan or they need four subscriptions per account? How fast can we get pricing up now?

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**Reed Hastings** - *Netflix, Inc. - CEO*

Rich, our entry-level plan in the US is actually \$7.99 for our standard-def one-stream plan, so it is incredibly affordable. And that's part of what's propelling our growth. We also want to motivate people to be able to move up to the two-stream and the high-def and also the ultra high-def plan as you referred to.

Over the last year, we've raised ASP about 5%. We'd like to keep that moving. So we're going to continue to have incentives for people to move up in the plans as suits their usage pattern, but we want to take it very slow. Things are going well, there's no reason to be disruptive. We're not planning anything in the US this quarter. It's really focused on going very steady, very slow. And over the next decade, I think we will be able to have more and more content and add more value, and then to be able to price that appropriately.

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

But are there other ways that you can increase price or tier pricing beyond 4K and number of subscriptions per household? Are there other choices that you've thought about or even tested anywhere globally to drive price or ARPU?

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**Reed Hastings** - *Netflix, Inc. - CEO*

I'm sure there are other ways to do it. The way that we have chosen is working very well for us. So then we tend to focus on the core, getting more content, more streaming, better usability, and the structure on the price tiering's unlikely to change.

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

A question for Ted. Going into this year, the Company had been saying for a while this is going to be a big original content year. It's showing through in the sub numbers. Does it set up this issue where every other year, you've got this tough comp in terms of new content?

How do you think about -- how do you follow this act? How robust will the new content be next year? Does each year have to ratchet up higher and higher in order that you don't go down with the subs and the stock and go up with the subs and the stock? How do you steady it out?

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

We have two things that are working for us. One, we're launching new shows that have become great brands on their own. But also as these shows grow into their second and third and fourth seasons, they're actually more attractive on their own. So we're adding more breadth of content, more original series, and those series have become bigger and bigger brands that down the road will become subscriber events as they grow.

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

And then David, let me ask you one more question just on the US subs. There was a new user interface on the desktop, that much more immersive experience. There were also a lot of competitive launches that maybe gained greater -- increased the focus on the streaming potential, the use case for consumers. Do you get the sense that either of those were materially impactful already or the user interface improvements of those [on the come] in terms of the impact on the sub base?

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**David Wells** - *Netflix, Inc. - CFO*

No Mark, generally we don't see when we do a large user interface improvement -- that's a very distributed effect. It's something that we're always focused on improving. Generally it rolls out across our device landscape.

We're pretty proud of a lot of the work that we've done, and in fact, it gets -- imitation is the best form of flattery. And so our user interfaces get imitated quite frequently across the world, and we're glad to be leading and innovating in that space. But it doesn't really translate immediately to subscriber growth. It's really a diffused retention benefit that we see through year over year in terms of the improvements in retention. And then in terms of the competitive announcements, we didn't see anything that was specific that we would point to.

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

Ted, you've talked about wanting to be HBO faster than HBO can become Netflix. When you think about the demographics of your user and how -- if Reed wants to get to 5 million to 6 million subscribers in the US each year going forward for several years, what types of content do you need to create? What are the demographics that you're weakest in that you need to figure out programming to hit beyond just simply the pricing plans that we talked about earlier?

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

I think what you're seeing, Rich, is that we're launching content to multiple demographics and all genres. So the reason why you're seeing the kind of engagement that you're seeing is that we're finding content that everyone can love. So not just one show that's meant to appeal to everybody, not a handful of shows that are meant to appeal just to the coast. We're doing shows that are very mainstream comedy, we're doing very elevated shows for some. We're also doing cartoons for kids.

So we really are programming across demographic and not trying to be one thing for all people or not having our brand really define what kind of content that we're doing. You've seen in a few of our recent announcements a traditional four-camera sitcom that we hope will be watched in even bigger than traditional way called *The Ranch* with Ashton Kutcher, bringing back the cast of *Full House* for a new show called *Fuller House*. But we're also doing things that are very edgy, very tough, cinematic shows like *Narcos* that's premiering next month or the revival of *Wet Hot American Summer* with an all-star cast with Paul Rudd and Bradley Cooper and Amy Poehler.

So it's really programming across demographics. When I said we wanted to get to be HBO before they got to be like Netflix, I meant that we'd have to get very good at original programming before they get really great at the technology and the direct to consumer relationships that they're only starting to invest in now.

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**Reed Hastings** - *Netflix, Inc. - CEO*

And Ted, do you want to just mention the success we've been having with Spanish language content in the US?

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

Absolutely. We've recently expanded beyond -- our own original shows, the only way to watch those shows in Spanish in the US is on Netflix with subtitles and dubs available that we're making for Latin America. And now we've licensed a lot of programming from Latin America into the US and are getting incredible viewing on shows that were successful for us in Mexico that are now drawing huge numbers in the US.

Again, it is a very different demographic than we've targeted before, and are just barely starting to touch them, but getting hundreds of thousands of hours a day on single shows. So we are really impressed with the relatively quick take up on these shows.

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

And maybe just trying this into international. As you think about the programming that you're now creating across these various segments or demographics, how are you thinking about the ability to leverage the programming, and what is the success of these individual programs overseas versus the US and some of the new markets that you have opened up and how that ties to, David, from a margin standpoint overseas. I think that is a big investor question.

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

The thing that has been very encouraging is that the proportion of international viewing of our series are pretty stacked the way you would expect relative to the subscriber base. So Orange Is the New Black and Sens8 have enjoyed great success all over the whole world, and all of our shows as we launch through differing degrees of indexing in some cases our US subscriber base or slightly under indexing depending on the install base and how US-centric or Latin American-centric the show might be.

We expect Narcos will be an enormous success throughout everywhere in the world and maybe out index in Latin America given the Brazilian star, Brazilian director and heavy Latin American cast and that we shot the show entirely on location in Colombia. We also think the show will be a huge hit for us in the US. We are seeing that great global storytelling is great storytelling.

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**David Wells** - *Netflix, Inc. - CFO*

Rich, just a Part B of that question in terms of -- for investors, obviously there are benefits if we produce the show if there is great reach across the world and we can distribute that show and it will be consumed and enjoyed across the world. So there's tremendous benefits there in terms of just the scale of distributing it.

As we see so far, content is being viewed, Western-produced, English language primary content is being consumed in large numbers across the world. There's a lot of similarities in terms of what people like. That's what Ted just talked about.

As we penetrate deeper into markets, there might be a question in terms of do we have to add more of a local mix into that, and that will have implications for our content spending in each market. Right now, what we are seeing is that our current mixture is working across the markets.

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

By the way, David, I think what's exciting about that is as we add local programming into those territories, that we will be able to find audiences for that around the world on Netflix, not just in that local territory. I think we will be able to find scale in local programming as well.

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

Let me switch over to just -- or follow up on the international questions. One for David, and then a bigger-picture one for Reed.

David, you had about 25% upside to the number of net international subs you thought you would have. Was that pure content, or were there other things that really helped in those markets, some marketing efficiencies that you found? A little bit more color, maybe some particular regions of the world that really outperformed versus your numbers?

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**David Wells** - Netflix, Inc. - CFO

For competitive reasons, we give less color on the international markets. But I would say you're right in the premise of the question being it's a little bit broader than just content driving that.

We think we've got some momentum that is based on brand growth in a number of markets as well. And we have a strong launch in Australia as well. So all of those things contributed to the success we saw in upside versus what we thought we were going to see in Q2.

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

And then Reed, big-picture question. There is a series of these international launches you've got aggressively planned it seems like this year and next year.

Can you just talk about how you plan to manage the execution risk associated with doing that many launches and that many major markets at once? How do you feel about managing the risk of a couple of these markets just going off the rails, not marketed right, not contented right, et cetera?

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**Reed Hastings** - Netflix, Inc. - CEO

I think that would be unlikely for any material market. If you look at the last four years, we've done a wide variety of launches, now over 50 nations, and we have learned along the way. I'm not too worried about that. We're very focused. I'd also say how we do in the first year in a new market is not that determinate of the long-term. If I think about Brazil, we're pretty weak in the first year, and now it's a rocket ship.

We're going to get in and really start the learning process. What's getting watched? Why? What's generating buzz? Why? And then, in every nation we're learning. And if you think about it, around the world, everybody wants this on demand Internet TV. It's just a better experience than linear TV. So I'm really very confident that internet TV is going to continue to grow.

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

This is probably a question that we can start with Reed, but you may all have a feeling about. Hulu was a pretty significant failure, I think self-admitted failure in Japan. Curious where did Hulu go wrong? Why will Netflix -- this is one of the biggest -- first major market in Asia you're going into. Why will Netflix be successful in Japan, and what are you going to do differently from the onset?

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**Reed Hastings** - Netflix, Inc. - CEO

Hulu had a couple of missteps. But now, today, four years later under new ownership, they are actually growing and seeing some real success in Japan. But the initial missteps were pricing was too high. It was JPY2000 or about \$20 at that time a month. It had no local content. So some pretty substantial missteps.

In contrast, our pricing will be more aggressive than theirs was. We will have local content. We may have some local originals. We're really focused on doing a great job. We've got more experience than they had at that time.

And Japan is a unique market because it is very brand sensitive. Japan will probably be our lowest slowest market to get to certain penetration thresholds. But it may be one of our best markets in the long-term because when the Japanese society embraces a brand, it is a very deep connection, very long term. So we're willing to make that investment knowing that it's not the quick route to success that might be in other countries.

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

And are you seeing the CE companies come out and support you ahead of launch?

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**Reed Hastings** - Netflix, Inc. - CEO

Yes. The CE companies, Sony and Panasonic and Toshiba, they are all integrating Netflix into their devices. And in fact, if you go today and buy a television in Japan, it is going to have a red Netflix button on it even though we have haven't yet launched.

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

Let me -- on the international side, David, if you could talk about the profitability ramps of some of the older markets that Netflix has been in and how they have looked versus either the US historically or some of the other older international markets. What's the profitability ramp look like?

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**David Wells** - Netflix, Inc. - CFO

Just like in the US, and we made some comments in the past on Canadian margin getting to a 30% threshold. We've made general steady improvements year over year. We had some headwinds this year with the VAT change in January and with some of the foreign exchange which we've denoted in the letter to give you an indication of the impact on the revenue.

But I'd say in general, the profile and the margin profile of each market is steady growth. We want to take a measured approach to make sure we're not running ahead too fast and underinvesting in the competitiveness of our offering. But in general, it's steady growth. And in fact, we've made comments before that our consolidated markets, our wave 1 or our first wave of markets were profitable on a consolidated basis, and in this case in this quarter, we expect them to be individually as well.

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

In terms of your guidance going forward, there was a little bit of a surprise to us. Your international operating loss is coming down sequentially even though you do have a bunch of launches. I know some of them are in October.

I guess the question, and I don't know if you will answer it or not, I doubt that this was the peak international loss quarter, the June quarter. Is it just a timing issue and we really should see the strong content marketing cost behind those launches in the fourth quarter, or did we just peak losses?

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**David Wells** - Netflix, Inc. - CFO

No, you are correct. We tried to walk through that in terms of the timing. We've got a Japanese launch later this quarter. So you're going to see new content expenses and market expenses related to Japan.



And then in Q4, you will see Southern Europe, Spain and Italy launch as well, so you've got brand new launches there. So you should expect those losses to continue to work towards that, and then next year we've got rest of world. So you've got some commentary there in terms of we expect those losses to continue to grow through the year.

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

And David, is it fair to say in our plans the international losses peak next year?

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**David Wells** - Netflix, Inc. - CFO

Yes. Absolutely.

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**Rich Greenfield** - BTIG - Analyst

When you look at a year ago or basically 15 months ago, you were on this videocast talking about your disappointment that you were forced to basically pay for interconnection and sign deals first with Comcast, then Verizon, AT&T and Time Warner Cable. Today, you are announcing that you've convinced Charter Communications as part of their attempted merger or acquisition of Time Warner Cable and Bright House to give up on interconnection fees for at least a term of the potential consent decree.

Why this issue, was this so important to you? Were you really that worried about these costs that you would support a merger simply to get settlement free peering?

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**Reed Hastings** - Netflix, Inc. - CEO

Rich, I think we've been really clear over the past five years that we saw interconnect fees as the potential next retrans where it starts off at very low numbers and then constantly escalates through a set of price discovery battles that impact consumers with various shutoffs to see who can take the pain. And then in general it sets up an ugly industry structure. And then in fact, settlement free was a much stronger way to go where broadband was great for what they do. We and our competitors have to be great for what we do, and we don't have to pay each other. An so we think that's the right way to go.

We're thrilled that Charter is willing to commit to that across the entire portfolio. I think that is a very substantial advantage for the public in terms of the growth of broadband in the US. So are really excited about it. What it does is it frees us up from worrying about getting taxed by an ISP, and instead we get to worry about how do we make our experience better for consumers.

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**Rich Greenfield** - BTIG - Analyst

Are there other conditions within Charter or Time Warner that you would like to see adopted from -- the government to adopt as part of a consent decree? And is there any way given how late in the game it is for you to get these types of clauses like settlement free peering into an AT&T DirecTV consent decree.

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**Reed Hastings** - Netflix, Inc. - CEO

From a broadband perspective, I think this is the right condition, and so this is the one we're focused on for Charter. And then the government is still working through potential conditions on AT&T Direct, and it would be great from our perspective now that the precedent is set and the details are clear if this merger condition proposed by Charter were also applied by the government to AT&T Direct.



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

Two more questions on international, one either for David or Ted. Can you just focus on the China market? And what are the variables, the key variables that determine when and how you will get into that market?

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**David Wells** - Netflix, Inc. - CFO

Sure, Mark. I would say China continues to be its own entity in terms of the challenges and the particular characteristics of the market. We're taking our time and being deliberate in finding a path and right model to work. Just continue to stay tuned. We hope to be able to launch a service there next year. We will continue to treat it as its own territory.

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**Reed Hastings** - Netflix, Inc. - CEO

We described it, Mark, as a modest investment once we launched. And nothing's changed since we used that word modest about our investment levels.

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

Reed, you've had long-term forecasts in terms of subs going back 10 years, and you've generally been -- it seems like you've been pretty right. The trends seem to definitely support this 60 million to 90 million, the ability to park it in there somewhere.

You also seem to have a lot of confidence now about a lot of your international launches, so what's that bogey? How many international subs do you think you can get to at some point in the long term?

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**Reed Hastings** - Netflix, Inc. - CEO

It depends upon the time frame I suppose. When we look at the global Internet, if you look at people who are in the future going to be on the Internet, are interested in video entertainment, watch some TV and have enough money to pay for service. That is a very large potential market.

How much of that we will get, how relevant we will be in Turkey, how relevant we will be in Indonesia. There is very open to question, and it depends on what kind of job we can do, how well we execute. The next couple of years, we will be able to have a clearer picture of how we will do in markets that are quite different from the US.

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**Rich Greenfield** - BTIG - Analyst

When you think about peering, obviously you did not get Comcast to submit to anything because the deal didn't happen. You had the deal that actually ended up being blocked. Is Comcast still a threat to Netflix given that they are the largest ISP in the country? You actively pushed for their deal to not happen, and they have no rules around interconnection as you look at it?

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**Reed Hastings** - Netflix, Inc. - CEO

There's lots of potential threats, and in some ways that's good for consumers that we have to compete with say Comcast's new offering called Stream. It's a potential threat on the peering interaction. The key thing about the Charter deal is it's all Internet companies that benefit -- us, Hulu, Amazon and HBO Now so that we can all compete for consumers' affection.



It's that openness to everybody that is the key thing. We can hope that over time Comcast will also get to settlement free. It hasn't happened yet. It's something that we will continue to work on.

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

And maybe a follow-up for Ted. When you think about the potential combinations, you've got John Malone talking pretty openly about Lionsgate and Starz and really wanting to roll up a whole number of companies into one mega content company. You have Fox tried to buy Time Warner, I think they still want to buy Time Warner if Jeff Bewkes was open to it. But is meaningful consolidation of studios, TV studios, a risk or a threat as you look at your access to content?

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

Rich, I really don't think it's a threat. I think it may be inevitable in what's happening around the world today. And I just think the underlying dynamics of being -- having a great supplier relationship with people who create content, they don't change in the ownership structure.

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

Let me follow up, Ted, two content questions. I think, Ted, at con, you said something like 10% of your content spend is now original and you would like it to get to 50%. I think that's consistent with comments you've made in the past. Any updated thoughts on the timing and speed with which you can get to that 50/50 level?

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

The intent wasn't to steer you toward a percentage -- it was to steer you away from it, meaning that what we're going to do is continue to grow our content spend on original programming both in absolute numbers and as a percentage of our total spending because it's been working. It's been helping grow the brand, and more importantly, it's been driving viewing hours.

Relative to how else we would spend the money, it's been a very efficient investment to program with original hours versus licensed hours, and that's why we keep pushing that out. I'm not trying to guide you to a specific percentage because at the end of the day, the total content spend doesn't change, just the slices of the pie do.

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**David Wells** - *Netflix, Inc. - CFO*

Sorry, Mark. I would just say that we're still, given our growth rate, able to grow licensed content. We're not yet at a stage where we're sacrificing or cannibalizing one for the other. The numbers that we put in there are characterizing in our long-term letter our future content budgets and the growth of those still allow for the growth of licensed content as well. It's just as Ted said a trade-off in terms of the brand implications and the efficiency for us.

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

And I think being a partner with the studios and networks and more importantly being a great source for consumers to watch that programming is always going to be part of our programming mix.

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

And Ted, one more content question and over to Rich. And Rich, if you don't ask Reed for his thoughts on the stock price, I will after that.



But Ted, the Disney content that's coming on next year, at a high level, could you explain to us how much of an impact that's going to have on overall content on the site? Do you think that that content that comes on, is it material enough to actually change net sub adds? Just from a high level, what is that content that is coming on, and for a basic Netflix user, what is the so what? How excited should they be?

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

Disney has situated themselves around a handful of very important, very global tent-pole brands like Lucas Films. Like Pixar. Like Disney Animation. Like Marvel.

That programming causes a great deal excitement for our subscribers both in terms of viewing hours and potentially they could be subscriber events. But more likely, it's about viewing hours and people finding great things to watch. And even things that they watch repeatedly, which is why I think that deal was more important to us than any other studio output deal could have been and maybe one of the few output deals that we pursue going forward because of the nature of that programming, that very specific programming.

It's very complementary to our growing Marvel relationship with our Daredevil series. And households with children love and trust the Disney brand, and we love the affiliation with it.

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

Does that -- playing off of that, when you think about Epix which is another output deal that you have a relationship with, you struck a deal five years ago. The first two years were exclusive, it was something that you used to help build Netflix.

The last few years it's been nonexclusive, on both Amazon as well as Netflix. Is that important to you anymore as that contract comes up for renewal anywhere near the price you've been reportedly paying?

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

It helped build us, and we certainly helped build Epix. And it does have a long-term conflict, which is I don't think it's in their long-term strategic best interest to have exclusive deals, and it is in ours.

So regardless of what happens in the short term, our long-term would be to move more towards exclusive programming, both films and series, and that deal I think would ultimately have a long-term conflict. But we want to have our viewers come to Netflix for great things that they love to watch, but we also want to be differentiated from all the other outlets.

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

So Reed and David, as you think about the stock price, I think we got a tremendous number of people asking, trying to tie back the performance. You're up well over 100% in after-hours trading year to date. Do you sense the same form or do you see the same type of euphoria that you cited in your investor letter not too long ago when you think about the stock price here, or is it warranted given your outperformance in the quarter or even year to date your performance?

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**Reed Hastings** - *Netflix, Inc. - CEO*

I think it probably shows why at least I should keep my day job and not try to be a stock picker because when the stock was half this price, I described it as euphoric. So it's a mystery to me. What we focus on is how to get incredible content, stream it beautifully, market it in every country, grow the member base. And I think I'm out of the stock commentary business.

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

Good. Rich, our jobs are safe. David, let's talk about the free cash flow in the quarter. You don't give guidance on free cash flow. Did the free cash flow loss that -- the \$230 million or whatever, was that largely what you thought it would be?

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**David Wells** - Netflix, Inc. - CFO

Yes. We've done our best to indicate the trend that our free cash flow is going to diverge (technical difficulty). And that's going to get worse as we invest more and more content. So indeed that was expected. You should expect that to continue as we invest heavily in our original content which is more front-end loaded from a cash basis perspective.

We've talked in the past about a ratio of content P&L expense to content cash. And that ratio has in terms of cash over the P&L been about 1.2 or 20% higher. It's drifted up to 1.3 and peaked at 1.4. We anticipate that ratio -- it was 1.3 in the quarter. That's still holding. Those comments are still valid and that trend will continue. As we invest in original movies and things that are particularly front-end loaded, you might see that peak at 1.4, but we think that ratio is still a pretty good guide for investors.

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

And David, you also put a ratio in the transcript or the release about running debt now at 4.6 times LTM EBITDA. I assume you wouldn't have put that in if that wasn't also something that you track. Do you want to comment on the upper and lower bound of acceptable -- upper and lower acceptable bands on that number?

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**David Wells** - Netflix, Inc. - CFO

I think we put that in there, Mark, just to make -- not to have people have to do their own math as particularly debt investors on the EBITDA number. The goal of that table is to put things that people will reference and easily want to know up front. That's why we put content commitments in there as well. And that's why we put EBITDA in there.

I don't think we have a target range on that. We fully expect as we invest more in international and as the international losses pull the consolidated P&L down over the next few quarters that that EBITDA number will get worse. We still have high confidence in profits delivered in 2017.

And it's back to your earlier question about how our existing international markets are doing from a profit growth perspective. Those markets are starting to grow. Each one is better year on year. The ones that were less -- not profitable last year are going to start to be profitable and then start to contribute meaningfully to profit, and then we will see on the new markets.

We have a comment on Japan being slow. We have new markets this year growing. So we have a longer-term view on the investments, and that's been validated at least in our earlier waves. So we've got great things to come we think.

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**Rich Greenfield** - BTIG - Analyst

When you think about the bundle, we've seen the bundle clearly starting to fray. Every MVPD we hear from is thinking about smaller bundles. We hearing about virtual MVPDs with smaller offerings even if Apple -- whenever Apple tries to get into the space.

There's clearly this kind of unbundling and then a re-bundling as we see new people put packages together the way Comcast is doing with the Stream that Reed mentioned earlier or even Hulu new packaging in Showtime. Is there a way for Netflix to be part of these new bundles, or do you prefer to just have it be a pure a la carte offering standing on its own?



**Reed Hastings** - *Netflix, Inc. - CEO*

Rich, when we look around the world, NOW TV, Sky's offering is an unbundling, Presto in Australia is an unbundling. Of course you know the US examples, and it's something we've seen broadly which is the rise of Internet TV and the idea that individual apps, being able to choose and all that's coming together.

In terms of being in a bundle, we would always want to be separately priced. We think the service is a great value, and it's up to consumers to choose that. So it might be a billed by a provider. So for example, Orange in France does that, and it's part of your cable -- if you will -- bill. But Netflix is a line item say at \$7.99 or whatever the local price is.

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

And from a product standpoint, you obviously refreshed the interface for laptops and PCs. Where are we? What are the big things you are thinking about? Where do you go from here in terms of product priorities as you move into 2016?

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**Reed Hastings** - *Netflix, Inc. - CEO*

The core is really continuing to improve the personalization. Being able to more and more accurately present content on the screen whether that's a TV screen or phone screen that a consumer is just very motivated to click on and watch. We've seen tremendous benefit as we've done more and more of the big data work.

In addition on the user interface, we're always working on performance, usability, testing new ideas. And we've got some pretty cool stuff in the lab with multi-video streams on the television screen. We see if it tests well. I'm pretty optimistic about it. There is a ton to learn as smart TVs get better and faster, as adapters like Chromecast get better. There's a lot of innovation on the hardware side that we are taking advantage of.

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

I'd like to get back to a specific question on the ARPU or ASPs. In the script, you mentioned seeing a nice uptake in their HD two-stream plan. Any more color around that, and also on the four digital out plan, the kind of uptake you've seen for that.

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**Reed Hastings** - *Netflix, Inc. - CEO*

On our top plan, which is the ultra HD four-stream plan, there are two drivers. There are people who have big families and want to watch more than two different screens at a time. And then the driver that we're really optimistic on is ultra HD. So as more and more ultra HD TVs gets sold at major electronics outlets over the next five years, more and more people will want ultra HD.

Each stream is about 15 megabits per second, so it takes a good quality Internet connection. Of course that's getting more and more reliable. So when we see those coming together, we see over time a significant percentage of our membership upgrading to get the ultra HD service again over the next couple of years.

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

And then one more question on pricing and particularly thoughts on global pricing. I think Reed, you mentioned in Japan trying to come in with an aggressive price point. As you think about all of the different markets you're going into, do you want to offer much lower tiered pricing plans for emerging markets, or do you want to try to maintain price integrity globally?

**Reed Hastings** - *Netflix, Inc. - CEO*

We are somewhere in between. Most of our pricing around the world is pretty close to the US pricing. Now the recent strength in the dollar and of course when you add VAT in in some cultures, in some societies, you have to back that out. If you look at the underlying price structure at this point, we're going for a model where it is pretty similar around the world.

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

When you think about Sandvine, I've been really surprised by the fact that Amazon, despite a pretty significant ramp in programming, still represents less than you increased your Sandvine bandwidth share over the course of the last six months. What do you attribute the fact to that no one else has really broken in despite some pretty substantial billion-dollar plus programming spend, no one else seems to be closing in on you. Why?

I think investors are trying to understand the barrier to entry. What is so different about Netflix? Are you becoming Kleenex for Internet streaming, or how do we explain what's happening?

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**Reed Hastings** - *Netflix, Inc. - CEO*

Amazon is growing very quickly in terms of total viewing hours. But so are we. And so what's happening is everyone's maintaining their relative share. But the total amount of Internet viewing is growing at a very vigorous rate.

So I think they are experiencing significant success in their investments as is Hulu. I think we will see that with HBO Now because there's this massive move from linear programming on to the Internet.

If you mean why is our share not compressed, that's a series of reasons. That's certainly the brand one, the Kleenex-type reason that you mentioned that leadership, gets conversation about leadership. It's also our only business. So we're totally focused on making a great consumer experience as an entertainment experience, and that's an advantage.

So there's a number of those factors. And we don't take it for granted. Those kinds of numbers can switch at any time. So we have to really continue to double down to do new things.

I think when you look for example at the original movie work that Ted's been doing, it is pretty incredible. You will see with *Beasts of No Nation* is very intense Oscar-caliber amazing film. And then with *Crouching Tiger and War Machine* with Brad Pitt coming, some really major big-ticket studio films debuting on Netflix around the world at the same time. So we're continuing to try to raise the ante to get better at what we do. I think that's the key to continuing to hold on to our share as the whole Internet TV market grows.

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

And when you think about the opportunity that you have for Internet TV, is there a way to think about how many more markets you can open up this year? I think you obviously talked about the Q3 launches. Are there Q4 launches that could still happen that have not yet been announced? We've gotten that question from several people.

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**Reed Hastings** - *Netflix, Inc. - CEO*

For Q4, we're focused on Spain, Portugal and Italy. Q3 being Japan.

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

Nothing else before year end?

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**Reed Hastings** - *Netflix, Inc. - CEO*

That's right. That's really going to be a big focus item in those markets for us these next two quarters. Nothing else before year end.

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

And is there anything else outside the US that wouldn't actually happen when you talk about international? Are there actual markets, anything of any substance that wouldn't happen in 2016?

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**Reed Hastings** - *Netflix, Inc. - CEO*

We hope to open the entire rest of the world in 2016. So China, again, we still have some things to figure out. So I suppose that's possible. But in the rest of the world, were pretty confident that will open. And then we will have to see how successful we are in Poland, and to see how successful we are in Indonesia. So there's still a lot of work to do.

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

A question for Ted, a specific one just on the Crouching Tiger. I think this question came in. I think that was pushed out, the launch date for that was pushed out. Any color around that?

And I think that will be the first one that will be released both on Netflix and in theaters, and it sounds like you want to do a few others that way. Is there greater concern on your part to make sure you get it right, or are there other factors?

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

There were a few other factors. One is that we're going to have a premier of Crouching Tiger Hidden Dragon 2 in China. It will premier on several screens in China in 3D, and we wanted to line it up with a better window in that way. Give the film a little more time. We also picked up a couple of extra production days to expand on the scope of the film. We're really happy with how it's coming out, and that window just lined up perfectly.

On the releasing in theaters, I think for us it's mostly symbolic. I think it's important for people to understand that these movies are not TV movies. They're on the same size and scale and scope of the movies that you see in theaters. So one way to do that is to have them in theaters sometimes.

I think the movies as they go will be attractive enough that theater owners will want to book them in their theaters at the same time that they're on Netflix. But in terms of -- I wouldn't move around to optimize for the theatrical window. So that's really not the driver. This afforded us to do a premiere a few days early in China and helped to launch the film and the film brand around the world.

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**Reed Hastings** - *Netflix, Inc. - CEO*

We probably have time for two more questions here, Mark.

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

Let me ask one question, and Rich, you get the last one. David, you talked a little bit about the global rights deals. And the implications of that for the P&L. Just a little bit more color there.

Do global rights deals as you do more and more of those, do those allow international margins long-term to rise up and maybe exceed even US levels, and when would we actually see some nice margin boost because of global rights deals. Is that three or four years out?

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**David Wells** - *Netflix, Inc. - CFO*

Mark, this is probably a combo for Ted as well, so I will take the first part and then he can comment. But generally it will take a while. The move towards a global right will be one that will take a few years to really flow through similarly to our move towards exclusivity.

And in terms of the P&L implications for international margins, it really is going to be more about the penetration growth and the rate of growth in that market to begin with. But sure, long-term we could see some benefits in terms of back to the earlier questions on the benefits of a global distribution, if we produce a piece of content that is consumed around the world, certainly there are benefits to being able to distribute that globally. And then Ted, I don't know if you have any comments that you wanted to pile on that.

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

Just the mechanics of it are simply that we try to gain more marginal subscription revenue and more marginal viewing hours than the marginal cost to pick up the rest of those rights and the rest of those territories. And there's been some -- we've been so encouraged by the international success of all of our original programming and other proof points like seeing Jurassic World open number one in all 66 theatrical markets around the world that if you get the content mix right, you can build the demand for it around the world in a pretty equal basis relative to the population. It's a pretty exciting opportunity, and we think there's a lot more.

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

When you look at the programming investments that you have made and the impact it's had on streaming hours, wondering if Reed could give us a quick update on where you stood in the quarter for total global streaming hours across your user base and just how different or how much of a gap is there between what a US subscriber is streaming per day and an international subscriber to understand the impact of your programming.

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**Reed Hastings** - *Netflix, Inc. - CEO*

Rich, US varies somewhat from Mexico varies somewhat from Norway, but if you look at them all on a graph, it's a big cloud. They're all pretty similar. The US is not unique compared to the range that we see around the world.

With each programming investment, we not only increase the viewing and increase the satisfaction, but we learn -- is that the kind of programming we should do more of. So you really want to think of us as just a learning machine in terms of the programming, the variety of what we've done. We get so much data about how people watch, how fast they watch, that it really propels our programming.

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

No update to the [10 billion]?

**Reed Hastings - Netflix, Inc. - CEO**

No update to the 10 billion. We will wait till we get to some nice fun and big number. But in terms of binge viewing, of course the most important thing about this call is to let you know that Friday, BoJack Horseman Season 2 launches on Friday. So we hope that everyone will have a great binge weekend on one of the most incredible shows. And it's kind of controversial when I quoted on this call Aaron Paul a couple of years ago, so I will stay away from the bad word. It is a delicious show.

Thanks you guys. That is all.

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