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Q1 2008 Netflix Earnings Conference Call  
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CORPORATE PARTICIPANTS  
   
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Reed Hastings Netflix, Inc. - Co-founder, CEO  
   
Barry McCarthy Netflix, Inc. - CFO  
CONFERENCE CALL PARTICIPANTS  
   
Doug Anmuth Lehman Brothers - Analyst  
   
Tony Wible Citigroup - Analyst  
   
Lloyd Walmsley Thomas Weisel Partners - Analyst  
   
Heath Terry Credit Suisse - Analyst  
PRESENTATION  
   
Operator  
Good day, everyone, and welcome to the Netflix first quarter 2008 earnings release conference. As a reminder, today's call is being  
recorded. At this time, for opening remarks and introductions I would like to turn the conference over to Deborah Crawford, Vice  
President of Investor Relations. Please go ahead, ma'am.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Thank you, and good afternoon. Welcome to Netflix's first quarter 2008 earnings call. Before turning the call over to Reed Hastings, the  
Company's Co-founder and CEO, I'll dispense with the customary cautionary language and comment about the webcast for this earnings  
call.  
We released earnings for the first quarter at approximately 1:05 p.m. Pacific time. The earnings release which includes a reconciliation of  
all non-GAAP financial measures to GAAP and this conference call are available at the Investor Relations Web site at www.netflix.com. A  
rebroadcast of this call will be available at the Netflix Web site after 3:30 p.m. Pacific time today.  
We will 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 28, 2008.  
And now, I would like to turn the call over to Reed.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Thank you, Deborah, and welcome everyone. Our goals at Netflix are simple, to be a great Internet movie service by combining  
DVD-by-mail with Internet streaming and to deliver growing EPS and subscribers every year. In Q1, we made significant progress on  
those goals and our momentum is reflected in our increased subscriber guidance for 2008.  
We currently expect at the midpoint of our guidance, 9.4 million subscribers by year end, an increase of 26% from 2007. In terms of EPS  
growth at the midpoint of our guidance we expect $1.23 in EPS for the year, up 27% from 2007. In Q1, the most telling metrics were  
subscriber net additions at 764,000, SAC at less than $30, and churn at 3.9%.  
All three were record performances over our six years as a public Company. We have been executing very well for many quarters as we  
steadily improve our service metrics, our customer satisfaction, and our competitive strength. Q1 was consistent with this strong trend, as  
opposed to something new. But in late December, our most direct competitor further rationalized their pricing which contributed to our  
Q1 surge in growth.  
Some of the positive impact from our competitors' price hike will be long lasting and some of it was a one-time benefit as their subscriber  
base responded to their price increase. So while Q1 was an all-time record in net additions, we don't expect Q2 to be a record second  
quarter or 2008 to be a record year in terms of net additions. In addition, we are planning on spending slightly less on marketing over the

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next three quarters than in the comparable periods of 2006, our biggest net additions year.  
We are very pleased, however, with our strong growth expectations of approximately 160,000 net adds for Q2 and 1.9 million for the full  
year, assuming the midpoint of our guidance because these growth levels are allowing us to aggressively fund our instant watching  
efforts. On the industry front in Q1, the High Def format war ended which is great for consumers and great for those of us with a vested  
interest in disc-based movie watching.  
Over the coming years, Blu-ray DVD players will fall in price and become more widespread. With the success of Blu-ray and its emerging  
economic importance to the studios, the DVD market is more likely than ever to remain enormous for many years into the future. As you  
are aware, purchasing Blu-ray DVDs costs more, both at retail and wholesale, than standard definition DVDs. Consumers are used to  
paying more for high definition content in every other channel including video rental stores, video on demand and cable channels.  
Because of the higher cost of Blu-ray and the consumer expectations around High Def content, we are planning on implementing a  
modest monthly premium for access to Blu-ray some time this year. Today, the percentage of our subs who rent Blu-ray is in the low  
single digits, but it is sure to grow going forward.  
While the success of Blu-ray is important to us, just as important are the improvements we have made to watching instantly over the  
Internet. Our selection continues to grow and we now have over 9,000 movies and TV episodes available. Today, our instant watching  
functionality is only available on Windows PCs which works well for our subscribers who is are comfortable watching video on their lap  
tops and for our technophile members who hook up their computers to their TVs.  
We have been happy, we have been very happy with the response to date amongst these groups. And viewing is growing rapidly. For  
many subscribers, however, watching instantly will expand in relevance as we make TV viewing easier and cheaper.  
As we talked about last quarter, we have adopted a partnership strategy in terms of Internet TV connectivity. As we increase our online  
content spending, our service becomes more attractive to consumers which in turn makes us more attractive to CE partners. In particular,  
we want our clients' software integrated into Internet connected Blu-ray players, game consoles, TVs, and stand alone set top devices.  
In January, we told you we were working with LG Electronics for a second half of 2008 product launch. At this point, I can tell you we  
have LG plus three additional partners actively working on integrating our technology into their products. Three of the four partners are  
major companies which each sell millions of devices per year and will enable the Netflix functionality in some of those devices likely in Q4  
of this year. The fourth partner is a small company which will likely launch sooner than Q4.  
Understandably, there has been investor excitement and along with it rumors about who we have partnered with. Despite our great  
success attracting major partners, about which you will see announcements in the coming quarters, these partnerships only demonstrate  
our success at providing Internet delivered content to our subscribers at no additional charge. Nothing about these agreements will be  
material to our financial results for the foreseeable future.  
While our efforts are a necessary first step as we expand into Internet delivery, providing free access to content is not a long-term formula  
for profitable growth. My second observation is that while we are off to a good start, providing consumer access to Internet-delivered  
content on their TVs will require many partnerships in addition to the big ones to be announced this year.  
My third and final observation is these partnerships have some execution and implementation risks as with all new technology. We will  
take it year by year and model by model as we and our CE partners come to understand the opportunity better. The big challenge for us  
remains the same as it was when we first launched our Internet delivery initiative, to satisfy ourselves and our shareholders that our  
online content spending will result in increased subscribers and profits.  
Despite my warnings to you about the many hurdles ahead, I would say we are thrilled with the progress we have achieved to date. Of  
course, as we succeed at new and improved consumer models for online movie enjoyment we are sure to attract more competition. Our  
competitive advantage is that if a consumer spends time on the Internet and enjoys movies, they are likely to be or become a Netflix

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subscriber.  
As we grow a larger subscriber base, our ability to offer both online streaming and DVD-by-mail at one low price means that we have a  
major advantage over any stand alone Internet delivery service, at least for the many years ahead, while DVD is significant. In addition,  
the Netflix Web site, which we constantly improve, includes billions of movie ratings, millions of customer reviews, and an engaged  
community which makes it particularly well suited for choosing movies to instantly watch.  
Let me wrap up where I began. Our goals are to be a great Internet movie service by combining DVD-by-mail with Internet streaming and  
to grow subscribers and EPS every year. The midpoint of our 2008 guidance of 27% EPS growth and 26% sub growth showed the  
effectiveness of our approach. And now, I'll turn the call over to Barry.  
   
Barry McCarthy Netflix, Inc. - CFO  
Thank you, Reed, and good afternoon, everyone. Three quarters ago on the July earnings call, we announced a price cut on some of our  
most popular subscription plans. Lower prices, we said, was an investment in faster growth.  
Faster growth is also what we expected when we raised guidance in February of 2008. Faster growth is what we reported today and  
faster growth is what we are forecasting for the remainder of 2008, both because of the ongoing benefits from lower prices and because  
of the current competitive environment.  
For the first time in six quarters, we saw an acceleration in year-over-year sub growth in Q1 to 21%. Growth and net subscriber additions  
set an all-time time, churn returned to its all-time low of 3.9%, and SAC reached a six-year low of $29.50. Looking back on our history as  
a public Company, I would say that on balance, this was one of our strongest quarters. We even saw strong growth in the Bay area, our  
highest penetrated market, where household penetration reached 18.6%, up from 17.6% in Q4.  
Growth was also strong in rest of the country, where average household penetration reached 7%, up from 6.3% in Q4. My remarks today  
will cover our Q1 performance.  
Next I will talk about our updated guidance for the remainder of the year and lastly I will comment on the $150 million buyback we  
announced in March. And rather than repeat the information presented in today's earnings release, my comments will focus, instead, on  
four metrics. These are gross margin, marketing spend, other income, and free cash flow.  
Gross margin of 31.7% declined 210 basis points sequentially in Q1. All of the decline was caused by a seasonal increase in disc usage  
which resulted in higher postage and packaging expense and fulfillment expense in quarter. These costs were partially offset by an  
expansion in margin relating to content cost which declined sequentially as a percent of revenue. The seasonal increase in usage in Q1  
was in line with our expectations.  
Marketing expense of $55 million increased $3 million sequentially, but declined by $17 million on a year-over-year basis for reasons I will  
explain in a moment. But first I want to remind you that not only was this quarter's SAC of $29.50 the lowest it has been since Q1 of  
2002, but it also declined 15% sequentially and 38% on a year-over-year basis. Lower SAC was driven by changes in the competitive  
environment combined with the July 2007 price decrease, both of which contributed to better response rates to Netflix advertising and  
more organic growth.  
For the remainder of the year, we expect lower marketing expense on a year-over-year basis, along with faster subscriber growth. Given  
the trend towards lower SAC over the last two quarters, the question investors often ask me is why aren't you spending more money on  
marketing to grow faster? The answer is we are investing more to grow faster, quite a bit more actually. So let me explain where.  
Last July, we said there are two ways to invest in faster growth, one, more marketing spending, or, two, price cuts. The path we chose was  
price cuts and judging from our accelerated growth these past two quarters, the investment seems to be working well. Interest and other  
income of $7.7 million grew 55% sequentially in Q1 as we realized $4.3 million in gains from the sale of short-term investments.

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Next quarter and for the remainder of the year we expect other income to consist primarily of interest income without the benefit of  
additional one-time gains. Free cash flow of $4.7 million in the quarter was $22.7 million better than the negative cash flow we saw in  
last year's first quarter and several million dollars better than we expected. Like last year, we saw a decline in free cash flow from Q4 to  
Q1. This seasonal decline was caused by a decrease in cash from operations as gift subscription sales slowed.  
We also increased our CapEx spending on content to support new subscriber growth and brought 80,000 square feet of new office space  
online here in Los Gatos. That concludes my comments on our Q1 performance, and now I'd like to share a few observations about  
guidance.  
Like last quarter, our guidance for the balance of 2008 assumes the market continues to grow. As in past years, we expect much of our  
subscriber growth will be front end and back end loaded in Q1 and Q4 respectively reflecting the historical pattern of seasonal growth.  
For the same reasons, we expect Q2 will again be our slowest quarter of subscriber growth.  
We expect to end Q2 with 8.3 million to 8.5 million subscribers and to end the year with an upwardly revised 9.1 million to 9.7 million  
subscribers. Revenue growth will continue to lag subscriber growth on a year-over-year basis throughout 2008 because of the price  
reduction we implemented in Q3 of last year. But we expect both subscriber growth and revenue growth to accelerate on a  
year-over-year basis in every quarter of the year. With the growth of the growth accelerating in Q3 as the effects of last year's price  
decrease disappear. In other words, the second derivative will increase a bunch in Q3.  
Gross margins will remain steady for the calendar year with a slight uptick in Q4, despite the cost of our growing library of content rights  
to Internet-delivered movies and TV content, and despite an expected increase in postage expense of $0.02 per round trip mailer  
beginning next month.  
With respect to guidance, I want to make a brief comment about expected tax rates. We determined that some of our research and  
development efforts in recent years qualify for federal and state tax credits. We anticipate filing appropriate refund claims in Q2. The  
credits attributable to 2007 and prior years will be recorded as a one-time benefit in Q2 and those benefits will lower our effective tax  
rate in Q2 to roughly 26%.  
For Q3 and Q4, we expect the tax rate to return to a normalized rate of 41% because these tax credits are no longer available at the  
federal level. And finally, I'd like to provide an update on the status of our stock buyback programs. During the first quarter of 2008, we  
announced and completed a $100 million buyback program repurchasing 3.8 million shares at an average cost of $25.99 and raising our  
cumulative share repurchases to 8.6 million shares at a total cost of $200 million, and an average cost of $23.31 per share.  
In March, we announced an additional share repurchase program of $150 million. All $150 million remains available to buy back shares.  
In closing, I would like to summarize my remarks this is way. We are off to a strong start in 2008. Operating results were strong in Q1.  
We reported strong results for three consecutive quarters and this momentum is reflected in the upwardly revised guidance we issued in  
today's earnings release. Today we reported record growth in gross and net subscriber additions, a reacceleration in subscriber growth,  
the lowest SAC we have ever reported as a public Company and record low churn.  
These metrics show the model is working well. At the same time, the market for DVD-by-mail subscription services remains strong and  
the competitive landscape remains favorable. Finally, as Reed mentioned, we're on track with our expansion into Internet video delivery  
and pleased with our success to date. That concludes my prepared remarks. Thank you all for joining us today, and now, operator, I think  
we're ready to take some questions.  
QUESTIONS AND ANSWERS  
   
Operator  
The question-and-answer session will be conducted electronically. (OPERATOR INSTRUCTIONS) We'll pause for just a moment to  
assemble the roster. We'll take our first question from Doug Anmuth, Lehman Brothers.

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Doug Anmuth Lehman Brothers - Analyst  
Thank you. I have two questions.  
First one is regarding Blockbusters' online subs, and can you talk, Barry, about how you would think about them if they were potentially  
to come for sale in the market? And then, secondly, in terms of the profitability outlook that you have for 2008, it's a little bit lower than  
we would have expected given some of the increase in subscribers and also in revenue.  
What else in particular is keeping down the profitability a little bit and how much is that due to higher than expected digital spending for  
the year? Thank you.  
   
Barry McCarthy Netflix, Inc. - CFO  
Hi, Doug, Barry. Let me do the second part of the question which is profitability, and I will flip the first part of the question over to Reed to  
deal with Blockbuster on line sub in the event of sale.  
With respect to profitability, the model from our perspective, from an operating perspective is actually performing extremely well. And to  
the extent that earnings for the calendar year are on a trajectory less than you were expecting probably the differential relates to the  
amount of spending that we are actually doing as compared with our forecast to bring onstream the capability to deliver movies over the  
Internet to different devices.  
Primarily, the spending is on the content side, and as Reed said and I reiterated we are enormously pleased with the progress we are  
making there.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Doug, it is Reed. A couple of years ago we were able to work out a soft landing for Wal-Mart.com because they had made a strategic  
decision that it didn't make sense for them, if for some reason Blockbuster made such a decision we could probably work something out.  
But they have been in the business for a couple of years. They have a big investment in their model. I would anticipate them to stay in the  
business for the foreseeable future.  
   
Doug Anmuth Lehman Brothers - Analyst  
Okay. Great. Thank you.  
   
Barry McCarthy Netflix, Inc. - CFO  
Doug, Barry. Let me make one additional point about profitability. People who have been following us for a long time realize this and  
investors who are new to us may not. Because we expense 100% of the cost of acquiring subscribers when they walk in the door there  
tends to be an inverse relationship in the current period between subscriber growth and profit. So it is several quarters before an acquired  
subscriber becomes profitable. To the extent that subscriber growth is running stronger than forecast, that pressure is in the current  
period, the P&L. So if for instance our subscriber growth is stronger than you were forecasting, it stands to reason that our net income  
would be lower than you were forecasting.  
   
Doug Anmuth Lehman Brothers - Analyst  
Got you. Great. Thank you.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Next question, operator.  
   
Operator  
Okay, just one moment. I apologize. We are experiencing some technical difficulties. Please stand by.  
One second. You are holding for the Netflix conference. We are experiencing some technical difficulties. We will try to get this resolved  
shortly. We thank you for your patience in holding, and please continue to stand by.

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Reed Hastings Netflix, Inc. - Co-founder, CEO  
Operator, if you want to e-mail us the next question, maybe we could answer it that way.  
   
Operator  
I will try. Just one moment. Again you are holding for the Netflix conference. We will be resuming shortly. We thank you for your patience  
in holding.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
So a more productive way to keep this moving might be to have people e-mail me the questions. My e-mail address is  
dcrawford@netflix.com and then we can just address them in order.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Okay. If the operators come back, we will flip back to the voice.  
   
Operator  
Thank you, Ms. Crawford, and I will let you know when our computer system has updated.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
So we will see which analysts can type their BlackBerry message fastest to us.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Okay, so, Brian Pitz at Banc of America, can you talk about where the growth in subscribers is coming from? Is it from offline or new  
users? To what extent did hollywood Video impact your growth?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Brian, certainly Hollywood's closures of stores helps, but when we have done specific studies of neighborhoods, we haven't seen a super  
strong correlation. So I would call it a positive background influence as opposed to a specific big driver.  
We definitely saw a positive increase beyond our initial expectations for the quarter because of the Blockbuster price increase. So that  
was the other contributor. Other than that, no material difference from the standard flow of the past couple of quarters.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Okay, Brian, I'm going to do one more for you and then I am going to keep going. Next question from Brian at B of A.. Can you comment  
on if you have seen any decrease in online advertising CPC, CPM rates due to a weaker economy?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
It is Reed again. No material change for us in the advertising climate.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Dan Ernst at Hudson Square. Can you quantify online spend? Where is it accounted for?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Online content I think that is, Barry.  
   
Barry McCarthy Netflix, Inc. - CFO  
Assuming the question is online content, Dan, it is accounted for in the cost of revenue line.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Okay. From Michael Olson at Piper, when you said gross margin will remain flat for the rest of the year with a slight uptick in Q4, just to  
clarify, are you saying Q2 and Q3 gross margin will be flat with Q1?

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Barry McCarthy Netflix, Inc. - CFO  
I am, yes.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Second question. What kinds of devices will the partners integrate Netflix with? Is it stand alone set top boxes or devices that consumers  
are already buying like flat panel TVs or Blu-ray players?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
We see the largest opportunity in multifunction devices such as Internet connected TVs, Internet connected Blu-ray players, Internet  
game consoles. But the set top into stand alone is a little more flexible. So some of the early partners may do those because they're  
easier to get to market. But it will be a mix and over time, I think, the volume will be in the hybrid devices.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Okay. This is from Heath Terry at CSFB. With the benefit from the lower tax rate to net income, why isn't there more of a positive impact  
on to net income guidance? Is there an offset in some other part of the expense structure?  
   
Barry McCarthy Netflix, Inc. - CFO  
Heath, Barry. No, there's no offset someplace else in the expense structure. It's just that we continue to invest stronger in growth and we  
continue to invest strongly in delivering ED content to increase the number of titles that we have licensed. So, said in the alternative, if  
net income, if we forecast lower net income, as a result, say, of a higher tax rate, some place in the P&L we would be paring our  
investment in future growth.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Okay. From Andy Hargreaves at Pacific Crest Securities. What other models are you considering for instant watch? Do you expect to have  
a distinct model for CE customers versus current customers?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Andy, I'm not sure exactly what you meant by CE customers. I'm going have to guess a little bit here. But today, consumers who are  
Netflix subscribers can rent DVDs and then in the same subscription for the same place also watch movies on their PC.  
What we would like to be able to do is make that watch movies extend to be able to watch movies on other devices. So think of it as a  
different viewing option, not a different subscription or commercial option.  
   
Barry McCarthy Netflix, Inc. - CFO  
All under the subscription rubric?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
As Barry said all under the subscription rubric. Our focus as a brand is really around unlimited subscription entertainment.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Lloyd Walmsley at TWP. You increased your subscriber guidance but maintained net income guidance. Are you seeing something in  
terms of SAC or lower content cost making you comfortable you can increase subscriber growth and maintain profitability? Second  
question, are you seeing lower online advertising prices or is it content driven?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Do you want to do the first part, Barry?  
   
Barry McCarthy Netflix, Inc. - CFO  
Sure. The, let's see. The model is more profitable than we were expecting it to be and that enables us to increase the growth and  
maintain the profitability.

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It is also true that we are seeing better yields on the advertising we are doing and more organic growth as I mentioned in my comments  
for this call, all of which enables the economic model to deliver incremental sub growth without a deterioration in profitability.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
I think, it's Reed here, an extension of that Lloyd, it is not fundamentally, it's not that we are getting lower CPMs materially. It is that the  
CPMs we're buying are more effective with a better competitive climate and are increasing brand awareness and reputation.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
From Tony Wible at Citigroup. Any change in thoughts on kiosks? Do you see them them as a greater threat or as a potential viable  
distribution model?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Tony, it is Reed. I don't see them particularly viable for us or important to us. They're viable, I think they will be around for a long time,  
and as I said in the last call, they hurt us a little bit and they help us a bunch in terms of triggering store closures because the kiosks focus  
really on the top 50 titles, they're very new release focused in their business. So it is a net benefit to us we believe.  
   
Barry McCarthy Netflix, Inc. - CFO  
I would say absent of competitive threat to the economic well being of the business which we don't see. We have the resources to make  
one large strategic investment. We have chosen to make that investment in growing our ability to deliver content over the Internet to TV  
sets and other devices in lieu of reinvest doubling down in the physical world.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Okay. Derek Brown from Cantor Fitzgerald, two questions. First, is watch instantly usage incremental to disc usage or replacement of  
disc usage or can you tell? Two, will BBI to go through with acquisition of Circuit City, how could you see this helping/hurting your  
business?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Derek, it is Reed. On the incremental versus replacement, we can't tell at this point. The types of consumers that are active users of  
instant watching are different types of users than others. So there's no clean control group.  
We are optimistic over time that there's only so many hours that people are going to watch content that there will be a substitution  
effect. Second, in terms of Blockbuster and Circuit City, not sure what it means. It is just too early to tell. We will see what they decide to  
do.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
From Ken Smith at Munder Capital. Can you comment on average revenue per subscriber? It appeared to be down sequentially quite a  
bit.  
   
Barry McCarthy Netflix, Inc. - CFO  
Ken, Barry. Two comments. One is I think sequentially, not so much.  
About on par with prior quarters and, secondly, you may recall that there have have been sources of ancillary revenue from advertising  
and from an affiliate called Red Envelope and both those lines of business have pared back their revenues. So it made the drop in ARPU  
look different than it would have looked if you were looking strictly at the ASP for the subscription business which was almost flat.  
So, I am not concerned about it. I would encourage you to not be either. Said differently, no structural change in the mix by price point of  
new subscribers, and no structural changes other than improvement in churn in the installed base.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
From Youssef Squali at Jefferies. On gross margins, 31.7% is the lowest you have had in seven quarters. Can you speak to why usage has  
increased? Second question, Redbox is getting a lot of traction. How do you see your value proposition versus theirs?.

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Barry McCarthy Netflix, Inc. - CFO  
Let Reed do Redbox and I will do usage. Usage is actually down. It is down for two reasons. One because of the plan mix towards lower  
price points and lower caps, and then, secondly, because aging of the subscriber base.  
So, and content costs in the aggregate have increased over what they have been, say, three years ago because of the investment we are  
making in the rights for Internet delivery. So, this really gets back to the question that Derek has which is about switching, if any,  
substitution between users of Internet-delivered movies and TV content and DVDs. And, this is a realtime experiment.  
We are driving strong growth and profitability from the core DVD business and in effect, investors have a free option for the moment on  
our ability to grow the, the business of delivering movies over the Internet to television sets. And we will only know over time how we  
need to fine tune that value proposition so that it works for consumers and works economically for Netflix.  
So the short answer is usage is trending down, up seasonally as we expected, exactly what we expected, and increased in content  
spending around growth of the new initiative.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
And, Youssef, you asked about Redbox and I think I answered that. I think your question was probably just written before I did that.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Next is from Jim Friedland at Cowen. Will you disclose percent of customers using instant watching target titles for year end on instant  
watching? That's the first question. The second is quarter-over-quarter growth in R&D was up a lot if Q1 this year and last year. Is there  
anything seasonal about spending in R&D or should we expect steady increase each quarter in R&D?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Jim, overall, I would expect R&D pretty steady. We do do the annual salary reviews at the end of Q4 Company-wide. So maybe that's a  
trigger for it.  
In terms of usage we have been very pleased with the adoption of the instant watching by our consumers, but we have chosen to not give  
out specific metrics on that. Similarly with target titles. We are up to 9,000 titles, up from I think it was 2,000 or 3,000 when we  
launched a year and a half ago. So we have made great progress and we continue to make great progress.  
   
Barry McCarthy Netflix, Inc. - CFO  
Jim, I have been here almost nine years and I used to tease Reed that we never met an engineer he didn't want to hire. Not having, that  
notwithstanding we have been pretty disciplined about the investment spending in R&D.  
We are crawling at aggressively, but those investments we have recouped in longer subscriber lifetimes and increased subscriber  
profitability with reductions in retention by making the features and functionality on the Web site more attractive to consumers and  
better (inaudible) utilized our investment in the DVD library, one. Two, we also are making an engineering investment associated with  
driving content to the Internet and some of the increase you are seeing reflects that R&D investment.  
So the bulk of the investment spending to drive content across the Internet to TV sets and the like is content and the other part of that  
shows up in R&D.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
All right. Dan Ernst just had a clarification from Hudson. I meant can you quantify the level of online content spend?  
   
Barry McCarthy Netflix, Inc. - CFO  
For competitive reasons, Dan, we are ducking that question.

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Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Next question is from [Neil Warner] at Foxhill Capital. What percentage of your customer base do you think will be renting Blu-ray by the  
end of the year?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Neil, I would guess it is still in the single digits. Christmas there will be a lot of players sold. So right at the end of the year it is a little bit  
of a fluctuation or improvement there, but probably single digits.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Okay. Next question from Barton Crockett. ARPU declined Q-over-Q, (inaudible) had said before mix change leveling out. That not the  
case now, wouldn't seasonally the trend have been to increase? I don't see that from here. That's the first question.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
The mix change, I don't think we have said in the past, Barton, that the mix change had leveled out. Even when the mix change does level  
out because of differences in churn rates due to different subscriber ages of new subscribers and old subscribers there will tend to be a  
slight differential. The majority of the change that you saw this quarter in ARPU is not due to revenue changes or pricing changes in the  
subscriber base. It is due to add revenue and other revenue which in aggregate account for the decline in ARPU sequentially.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Next question, also from Barton, $4.3 million not in cash gain from sale of short-term investments. What was that, was that  
contemplated in guidance?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
It wasn't originally contemplated in guidance, but as the quarter progressed two things happened. We increased, we decided to increase  
our investment in marketing spending above the levels that we had forecast when we gave guidance.  
Secondly, we forecast as the economy improves and increase in interest rates. From my perspective it was a good opportunity for us to  
realize a gain in our investment portfolio that might not be there in quarters to come. So, we used the sale of the gain on the, in the  
investment portfolio to, in effect, fund some incremental investing in additional marketing and faster growth and to hold the P&L cost.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
From Doug Anmuth at Lehman Brothers. Is there any significant change in your view on digital spend for '08 versus what you saw three  
months ago? Let's start there.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
No, Doug. I would say our spending plan is about what we thought it would be three months ago and it does continue to proceed nicely  
for us as we have seen the validators of the significant usage, and it is because we have a lot of online content that we have been able to  
get these great partnerships that we will be talking about later this year.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Next question also from Doug at Lehman. Any change in competitive landscape in last three months, seeing Blockbuster be any more  
aggressive with spending?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Well, obviously Blockbuster has changed many times and they may change again. But for the last three months there have been fairly  
minimal amounts of marketing from Blockbuster.

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Deborah Crawford Netflix, Inc. - VP, Investor Relations  
From Youssef Squali at Jefferies, and after this I think we can go to the operator to see if there are any final questions. Last one that I  
have here. From Youssef Squali, your GAAP net income for fiscal year '08 is unchanged, but your GAAP EPS is lower. Why is that, is it  
option related?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Great question. Thanks for asking. Yes, it is.  
We use a Treasury method and because the price of the underlying stock has increased, under the Treasury method it takes fewer options  
for a net exercise. As a result, the number of outstanding shares is assumed to be greater which has resulted in, I think, it is a $0.01  
decrease in the projections for EPS on the same GAAP net income.  
   
Deborah Crawford Netflix, Inc. - VP, Investor Relations  
Operator, can we open it back up or do you want me to continue reading questions?  
   
Operator  
We can open it back up. (OPERATOR INSTRUCTIONS) We will pause for just a moment. First, we will hear from Tony Wible with Citi.  
   
Tony Wible Citigroup - Analyst  
Good afternoon. I was hoping you guys could comment on if you have seen any change in some of the metrics, in some of the share gain  
subs, and some of the newer subs coming on, do they have any better or worse ARPU, margin or churn trends? I know it is maybe a little  
early on the churn question, but any color would be helpful.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Tony, it is Reed. No, we don't see any difference in the kind of character of the new subs in the share gain over Q1 than in prior quarters.  
   
Tony Wible Citigroup - Analyst  
And what do you still feel is the best use of cash after you burned through the $150 million, roughly, that is remaining?  
   
Barry McCarthy Netflix, Inc. - CFO  
More buyback.  
   
Tony Wible Citigroup - Analyst  
More buyback. All right. Thank you.  
   
Operator  
Next we will hear from Lloyd Walmsley, Thomas Weisel Partners.  
   
Lloyd Walmsley Thomas Weisel Partners - Analyst  
Great. I was wondering if you guys could comment on the landscape for digital content rights acquisition, and in particular, if you see any  
changes coming out of the new pay TV plans announced yesterday by Paramount, MGM and Lionsgate? And then if you could perhaps as  
a follow-up to that just talk about how you have structured those deals in terms of fixed costs versus variable cost driven by usage?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Lloyd, it is Reed, obviously, there's a lot changing in terms of the specific new Viacom, MGM, Lionsgate initiative. It is too early to tell  
what the impact of that will be in the marketplace, and then we contract for content, try to go get the best deal we can.  
Sometimes that's fixed, sometimes it is pay-per-view, sometimes it's other mixed models. We are pretty flexible on that in the search for  
a good deal. Operator, I think we will take one last question if we have one, otherwise we will.

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Operator  
We will take one final question from Heath Terry, Credit Suisse.  
   
Heath Terry Credit Suisse - Analyst  
Great.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Heath, take us home.  
   
Heath Terry Credit Suisse - Analyst  
All right. I was going to ask, the watch instantly customers that you have got, can you give us an idea of what kind of, if you are seeing  
any difference in the churn rate among those that are using watch instantly and what kind of penetration you are getting for the service  
among the subscriber base?  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Heath, it is Reed, you know, we are really excited by the usage because you don't keep using something unless you are satisfied with it.  
But, again, without a control group to identify what the compare the churn to the base of people who watch a lot of movies and watch  
content on their PC are different than other subscribers. So we can't tell you kind of the direct retention impact.  
But we can tell you that the usage has really impressed us, that there is many more people willing to watch a lot more content than we  
thought on the PCs, and we are looking forward to them expanding that to the television and the more that people interact with Netflix,  
the more they feel good about it -- consumers, and the more they tell their friends about it. So very confident that it is a positive influence  
for us, but without the control group can't give you a perfect sense of the number, the size of that gap.  
   
Heath Terry Credit Suisse - Analyst  
Great. Thank you.  
   
Reed Hastings Netflix, Inc. - Co-founder, CEO  
Well, thank you everyone for joining us on the call. I'm sorry for those technical difficulties, but you all got your questions in very well, and  
we look forward to talking to you over the quarter and on our next call. Thank you.  
   
Operator  
That does conclude today's Netflix conference. We thank you all for joining us.  
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Reed Hastings Netflix - Co-Founder & CEO  
   
Barry McCarthy Netflix - CFO  
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Doug Anmuth Lehman Brothers - Analyst  
   
Tony Wible Citigroup - Analyst  
   
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Lloyd Walmsley Thomas Weisel Partners - Analyst  
   
Jim Friedland Cowen and Company - Analyst  
   
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Ken Smith - Analyst  
   
Michael Pachter Wedbush Morgan Securities - Analyst  
   
Daniel Leonard First Analysis Securities - Analyst  
   
Ryan Hunter - Analyst  
PRESENTATION  
   
Operator  
Good day, everyone. Welcome to the Netflix second quarter earnings conference call. Today's call is being recorded.  
At this time, for opening remarks and introductions, I would like to turn the call over to Deborah Crawford, Vice President of Investor  
Relations. Please go ahead.  
   
Deborah Crawford Netflix - VP of IR  
Thank you and good morning. Welcome to Netflix's second quarter 2008 earnings call. Before turning the call over to Reed Hastings, the  
Company's Co-Founder and CEO, I'll dispense with the customary cautionary language and comment about the webcast for this earnings  
call. We will 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 28th, 2008. We released earnings for the second quarter at approximately 4:00 a.m. Pacific time. The  
earnings release, which includes a reconciliation of all non-GAAP financial measures to GAAP, and this conference call are available at  
the Company's investor relations' website at www.netflix.com. A rebroadcast of this call will be available at the Netflix website after 8:30  
a.m. Pacific time today.  
Finally, as we noted in the press release we issued earlier this morning, we are going to conduct the question portion of the Q&A via  
email. Please email your questions to me at dcrawford@netflix.com. If you recall, last quarter technical difficulties forced us to take  
questions via email and Reed and Barry responded to them on the call. As it happens, we received a lot of positive feedback last quarter,  
so we're going to try it again this quarter. Please let us know what you think. Now I would like to turn the call over to Reed.  
   
Reed Hastings Netflix - Co-Founder & CEO  
Thanks, Deborah and welcome, everyone. Our goal with Netflix is very simple, to materially grow subscribers and EPS every year while  
expanding the unlimited enjoyment we offer with DVD by mail to also include unlimited internet streaming. Once again, our quarterly  
results reflect strong progress towards this goal. We delivered our lowest ever SAC as a public company, profits at the top end of our  
guidance, and ending subscribers above the midpoint of our guidance. In addition, we made significant progress on our expansion into  
streaming with a launch of the Netflix player by Roku, the announcement of our X-Box partnership last week and our continued growth  
in the number of movies and TV episodes available to our subscribers for unlimited streaming. We discussed at length our views on the  
market and how we are approaching it at our Investor Day about eight weeks ago. In summary, we think that DVD by mail will continue  
to grow for five to 10 years, despite overall DVD rental flatness, as ecommerce continues to grow generally and as video store economics

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force more store closures.  
As we expand more into streaming, we are improving our core consumer proposition of unlimited enjoyment for a low monthly fee by  
combining unlimited DVDs by mail with unlimited streaming. We don't plan to enter the pay-per-view segment, where Apple, Amazon,  
Sony and others focus, or the ad supported segments where Hulu, YouTube and others compete. Both of those segments will likely be  
substantial, but our subscription segment will also be large and will provide Netflix plenty of room for growth over the coming years. In  
order to succeed broadly with streaming, we need it to be easy and inexpensive for consumers to watch internet video on their television  
screen.  
Specifically, our goal is to have our streaming software integrated into Blu-ray players, game consoles, connected to DVD and  
stand-alone internet devices. Our substantial streaming content, available to consumers on an unlimited viewing basis, makes it  
attractive for consumer electronics companies to integrate our streaming software, because it increases the attractiveness of their  
devices, and we promote their devices to our large subscriber base. Our results to date with this approach have been excellent, starting  
with the launch of the Roku box in May. This $99 box allows Netflix subscribers to instantly stream movies and TV episodes to their TVs.  
It's been a huge hit with strong reviews, strong sales, and great subscriber satisfaction. Roku purchasers are streaming video to their TVs  
and getting great value from the unlimited streaming portion of their Netflix membership. In the future, Roku boxes will support other  
internet video content and migrate from being a Netflix only player to a general internet video player, which will increase Roku sales and  
therefore the number of TVs we can stream to.  
We also have a technology partnership with LG Electronics, which we'll be discussing in more detail soon, one other similar partner not  
yet announced, and the X-Box partnership which we announced last week. The X-Box partnership means that with Microsoft's late fall  
software update to over 10 million domestic X-Box 360s, Netflix members can stream movies and TV episodes to their TVs, as long as  
they are also X-Box LIVE Gold members. As with our streaming to the Roku box and to the PC, there is no extra Netflix charge for the  
unlimited streaming. While our strategy is to achieve ubiquity, we were willing to do an exclusive partnership in the game console  
segment because of the very large installed base of 10 million households that X-Box has developed. We believe this will be our only  
exclusive deal in any segment. Since the X-Box software update is scheduled for late fall, its impact during this calendar year is unclear.  
While this functionality will certainly increase streaming amongst our current subscribers, we and Microsoft have yet to really understand  
how much it will drive additional LIVE Gold subscriptions, new console sales, and how much it will drive additional Netflix subscriptions.  
As we both learn more about the attractiveness of this joint functionality with consumers, we will use that information to determine the  
extent of our promotional activities over the next year. In the best case, substantial cross-promotion in 2009 will make economic sense  
for both parties in terms of increased efficient growth.  
Between the large and growing X-Box installed base, the strong sales of Roku boxes and the anticipated sales of the Netflix ready LG  
device, we are off to a very solid start. As I mentioned earlier, as we increased the number of connected TVs, we are also increasing the  
content we are making available. In fact, over the last 18 months we've grown our number of choices from 2,000 to over 12,000, and we  
plan to continue to increase the amount of content available. This planned investment is already factored into our earnings guidance.  
Shifting to the competitive climate, Blockbuster remained active in DVD by mail over the quarter. Our guidance for the year assumes that  
they continued to stay active at similar levels for the rest of the year. The rise of DVD rental kiosks in supermarkets, while new  
competition for us in the short term, is a bigger competitor for new release focused video stores and should accelerate store closures over  
the coming years. In addition, the rise of DVD rental kiosks shows that the DVD franchise is still very strong with mainstream consumers.  
In the long term, we think it is likely that DVD by mail and DVD rental kiosks will continue to increase their share of the DVD rental  
market at the expense of stores.  
To close, our goal is to materially increase subscribers and EPS every year as we expand into streaming and this quarter we continued to  
make excellent progress towards that goal. Thank you and now I would like to turn the call over to Barry for a more detailed discussion of  
our Q2 results.

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Barry McCarthy Netflix - CFO  
Thank you, Reed and good morning, everyone. My remarks will cover three areas, our Q2 performance, our guidance for the remainder of  
the year, and an update on the share repurchase program we announced in March.  
Like last quarter, our Q2 financial performance was strong, with revenue above the midpoint of guidance and net income and EPS at the  
high end of the range of our guidance. This year's second quarter followed a well-established seasonal pattern of slower subscriber  
growth and increased profitability, which we spoke about on last quarter's earnings call. Seasonally slower subscriber growth was  
accompanied by record high operating profit of $33.5 million, when you exclude one-time items from prior year comparisons, and strong  
free cash flow of $12.5 million. Free cash flow nearly tripled sequentially and I'll say more about that in a moment, in spite of our growing  
investment in content rights to distribute internet-delivered movies and TV content. Gross margin was 10 basis points higher than it was  
in Q1, as expected.  
Looking at the components of cost as a percent of revenue, we see that a small increase in content spending was offset by an equally  
small decline in both fulfillment and shipping and packaging expense, despite the postal rate increase in May. We expect gross margin  
to be up slightly in Q3 and Q4, despite our ongoing investments in internet delivered movies and TV content. Excuse me. With the  
seasonal decline in subscriber acquisition in Q2, our marketing expense declined by $15 million or 27% sequentially to just under 10% of  
revenue. As a percent of revenue, this represents the lowest quarterly marketing spend in our history as a public company. In Q2 we  
expensed $40.1 million on marketing. That's $5.2 million less than we expensed in Q2 of last year or about an 11% decrease in marketing  
expense. What's remarkable about the lower spending is that gross subscriber additions continue to grow anyway on a year-over-year  
basis. SAC declined again this quarter to just under $29, the lowest SAC has ever been since taking the Company public in 2002. This  
seasonal decline in marketing spending was the primary contributor to the increase in operating income in the quarter.  
A second large contributor to the increased profitability in Q2 was the expected decline in our effective tax rate from 41% to 26% in Q2.  
This was something we discussed with you on last quarter's earnings call. The tax rate decline relates to a one-time R&D tax credit and  
we expect a return to 41% into Q3 and Q4. Free cash flow of $12.5 million in Q2 nearly doubled from a year ago and nearly tripled  
sequentially. Higher net income was the primary contributor to the sequential growth in free cash flow, coupled with a $10 million  
sequential decline in content spending. These sources of cash were offset by a decline in AP and accrued expenses of $11 million. On a  
year-over-year basis, there were three primary contributors to the growth in free cash flow. First, the increase in depreciation on PP&E  
and the amortization of content. Second, the growth in AP plus accrued expenses, net of excess tax benefits on stock comp. And lastly,  
the growth in long-term income taxes payable, related to the R&D tax credit. Although this is the second consecutive quarter of  
exceptionally strong free cash flow growth, I don't expect these hyper growth rates of 100%-plus to continue through in Q3 and Q4.  
When the dust settles and we look back on the year's results, year-over-year growth and free cash flow for the full year of 35% to 45%  
seems possible.  
Today's earnings release includes subscriber revenue net income and the EPS guidance for the third and fourth quarters. Today, we  
reaffirmed our year-end subscriber and net income guidance, tightened our full year revenue guidance, and raised our guidance for EPS,  
reflecting our expectations for a lower weighted average share count by year end.  
It's worth mentioning that we expect year-over-year revenue growth to accelerate in Q3 and again in Q4 as the effects of last year's Q3  
price decrease slip away for comparison purposes. And by the way, we saw year-over-year revenue growth begin to accelerate this past  
quarter from 7% in Q1 to 11% in Q2, the first acceleration in the last seven quarters.  
With regard to our share count, I'd like to talk briefly about the status of our share repurchase program. In March, we announced an  
additional share repurchase program of $150 million. All $150 million is currently available to buy back shares. No shares were  
repurchased last quarter because we closed the trading window pending the Microsoft announcement on July 14th. If the trading  
program had been open during the quarter, we would have been buyers of Netflix stock at these prices.  
That concludes my prepared remarks. Now it's time to answer your questions and, as Deborah mentioned at the beginning of our call, we  
would like you to email your questions to dcrawford@netflix.com as we did last quarter. Deborah will read the questions out load and

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Reed and I will do our best to answer them. As Deborah mentioned, we received lots of positive feedback on this approach last quarter  
and were able to answer more questions from more investors than we typically get to. So we thought we'd try this format again. So  
Deborah, over to you for the first question.  
QUESTIONS AND ANSWERS  
   
Deborah Crawford Netflix - VP of IR  
Thank you. The first question is from Barton Crockett at JP Morgan.  
   
Barton Crockett JPMorgan - Analyst  
First question, what drove down stocks, lower pricing of media i.e. lower Yahoo! CPMs or was advertising simply more effective? Could  
that be a function of better word of mouth, impact of service cuts or greater consumer interest, perhaps due to higher gas prices?  
   
Reed Hastings Netflix - Co-Founder & CEO  
It's Reed, Barton. I don't think it's the outside advertising climate which hasn't shifted materially for us. It's mostly that we are spending  
less marketing as a percentage of revenue, so we're trying to push the market less hard than we have in the past. Second, better  
competitive climate than last year and then third, we made a big investment with lower prices last year, last Q3, we lowered our prices  
and we think of lowering prices as a marketing investment, although it's not reflected in fact. So those three factors have helped us to  
achieve this very efficient sub $30 SAC.  
   
Barton Crockett JPMorgan - Analyst  
Also, talk about the expected subscriber and economic impact of the X-Box deal. Is there one other major announcement still to come  
with another partner this year?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Barton, I answered that question. You sent it in just before I read the script, but I think I've covered that. That this year, hard to tell  
because it's a late fall update. Next year we're optimistic that the cross-promotions will be economically efficient for both parties.  
   
Barton Crockett JPMorgan - Analyst  
Shutting down red envelope, talk about why.  
   
Reed Hastings Netflix - Co-Founder & CEO  
On red envelope, we did some experiments, tried to figure out an economic model that was scalable and sensible, unable to do that. We  
decided to close it down and all the closure costs are baked into our current guidance.  
   
Barton Crockett JPMorgan - Analyst  
Are DVD trends being impacted by gas prices or the economy?  
   
Reed Hastings Netflix - Co-Founder & CEO  
We don't comment on usage.  
   
Deborah Crawford Netflix - VP of IR  
Next set of questions from Doug Anmuth at Lehman Brothers.  
   
Doug Anmuth Lehman Brothers - Analyst  
The fact that it's lowest ever for Netflix as a public company, why not push the marketing a little further for more subs ahead of the back  
half?

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Reed Hastings Netflix - Co-Founder & CEO  
That's an interesting question and something we debate, which is the balance of really earnings versus growth. And certainly there are  
good arguments that we could have taken, generated less earnings and pushed more into growth. But at the end of the day, we think it's  
better to stick to our earnings targets, despite these great opportunities. And it does give us substantial room for growth so I don't feel  
like we're making bad choices, but it is a very attractive opportunity when SAC is as low as it is.  
   
Doug Anmuth Lehman Brothers - Analyst  
Is it becoming more competitive to partner with CE manufacturers now that Amazon has turned to streaming, i.e., and signed a deal with  
Sony and possibly others?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Well, Amazon's pay-per-view stream service is very nicely implemented and I think what we're going to see is them also emerging to  
various devices. Again, that's really the pay-per-view new release focus content and in many ways you need that, you need our  
subscription service and you need ad supported content from, say, Hulu and NBC.com and ABC.com and others to really form a total  
internet video solution on these devices. So I don't think it's competing against each other. We're not trying to block them. I don't know of  
them trying to block us. These are really different segments, the ad supported, the pay-per-view segment and the subscription segment.  
   
Doug Anmuth Lehman Brothers - Analyst  
Finally, can you provide more color on digital usage? What percentage of subscriber bases stream are digital users turning less and using  
fewer discs? What percentage of total usage is digital?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Like eight weeks ago, we haven't given any color on the specific trends around watching, it's just too early to tell and we don't have a  
control group that doesn't get instant watching. So there's really no easy way for us to say anything conclusively. We're very encouraged  
by the usage, people are watching, are instant watching in significantly and growing numbers. That's very exciting. But at this point we  
don't have any specific numbers to provide.  
   
Deborah Crawford Netflix - VP of IR  
From Tony Wible of CitiGroup.  
   
Tony Wible Citigroup - Analyst  
Can you speak to if you have seen higher DVD consumption trends in your core DVD subscriber base over the past quarter versus last  
year to adjust for seasonality?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Tony, thanks for the question. Again, we're not commenting on usage specifically.  
   
Deborah Crawford Netflix - VP of IR  
This is from Michael Olson at Piper Jaffray.  
   
Michael Olson Piper Jaffray - Analyst  
Any more details you can provide on potential pricing changes for Blu-ray or Watch Instantly? Is there a threshold of Blu-ray or Watch  
Instantly subscribers that you are looking to reach before raising prices or what is the trigger for those potential changes?  
   
Reed Hastings Netflix - Co-Founder & CEO  
We'll be commencing the testing of Blu-ray price increases very shortly. Depending on the test results of those, then we'll move forward  
with implementing.

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Michael Olson Piper Jaffray - Analyst  
Next question also from Michael Olson. What should we expect for gross margin going forward? Is there any potential to get back to the  
33% to 34% level of '07 or should we expect it to be kept at 32% in the near term? What is keeping the ceiling on gross margin?  
   
Barry McCarthy Netflix - CFO  
Well, as I said in my remarks, we expect gross margin will increase next quarter, which is a change from our expectations in Q1. And I  
expect it to be up in Q4 as compared with the current quarter, although not quite as strong as it was in Q3.  
As relates to the question around how high can gross margin go, answer it this way. If gross margin rose to 35% or 36%, it would not  
necessarily mean that the business is more profitable. There's a relationship that we've continued to explore during our history as a  
public company between customer SAT and gross margin. And in some respects, they're inversely related and since customer SAT drives  
at least indirectly SAC, and retention which drives lifetime value, sometimes the business is more profitable with lower SAC, higher  
retention, lower churn, higher lifetime value and lower gross margin. And we learned that experience when we launched Hubs and we're  
exploring those interrelationships again with the launch of the Watch Now service. So it remains to be seen what will happen with gross  
margins over time. So at least through year end, we expect some improvement. What the implications are for '09 and '10, it depends on  
the interrelationship between lifetime value, SAC and gross margin, as we expand the number of titles available for internet  
downloading and as the number of devices available for people to view that content on their TV sets increases.  
   
Deborah Crawford Netflix - VP of IR  
Next question is from Lloyd Walmsley at Thomas Weisel Partners.  
   
Lloyd Walmsley Thomas Weisel Partners - Analyst  
As new subscribers come in, do you have any intelligence on where they are coming from? Do you think a weak economy may be driving  
subscribers off pay TV to Netflix? Do new subscribers tend to use the service more and are your most profitable subscribers, those who  
use the service very little, leaving the service as they cut costs?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Lloyd, I don't see anything related to the depressing economic picture that we face, which is tempting to put a lot of -- to read the tea  
leaves about how it's affecting Netflix. But we're not really able to tell is that why we're going so strongly or would we have been growing  
even more strongly if the economy had been strong. In terms of where subs are coming from, no real changes. New subscribers do use  
more than older subscribers. But that's been true for 10 years for us. So no material change there. Overall, the wonderful thing about the  
Netflix business is we appear to be substantially unaffected by this significant economic negative climate. So we're very happy about  
that.  
   
Lloyd Walmsley Thomas Weisel Partners - Analyst  
Second question, what percentage of the subscriber base is using Blu-ray?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Blu-ray usage has continued to be very low -- low single digits. It's something that has promise over the next couple years, particularly  
through this Christmas season and beyond, if player prices fall significantly. This will be the first Christmas coming up where there is  
dedicated players that are at more aggressive prices.  
   
Deborah Crawford Netflix - VP of IR  
Two questions from Jim Friedland at Cowen and Company.  
   
Jim Friedland Cowen and Company - Analyst  
As digital demand ramps, what will the impact be on your infrastructure needs? How should we think about CapEx growth over the next  
couple of years?

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Reed Hastings Netflix - Co-Founder & CEO  
In terms of CapEx for digital delivery, very little impact. Most of that delivery infrastructure is through third party CDMs. So no particular  
connection there.  
   
Jim Friedland Cowen and Company - Analyst  
Second question. How long does the exclusivity on the X-Box deal last?  
   
Reed Hastings Netflix - Co-Founder & CEO  
We haven't commented on the particulars of the duration.  
   
Michael Olson Piper Jaffray - Analyst  
Another question from Michael Olson at Piper. Why was other income so low in this quarter and what should we expect it to be the rest of  
this year?  
   
Barry McCarthy Netflix - CFO  
Well, Michael, follow up if I don't address your question specifically. There's the combination of other interests -- it's mostly interest rates  
are down, long story short.  
   
Deborah Crawford Netflix - VP of IR  
Questions from Andy Hargreaves at Pacific Crest Securities.  
   
Andy Hargreaves Pacific Crest Securities - Analyst  
Why was the content library on the balance sheet down so much Q over Q? Sorry, why was the content library on the balance sheet down  
so much Q over Q?  
   
Barry McCarthy Netflix - CFO  
Well, we spent less on new content and it was a relatively weak new release box office and -- one. Two, the two components that -- two,  
content acquisition, we buy some content outright that affects CapEx. We also rev share content with studios. So sometimes there's  
switching of -- from a CapEx versus a P&L perspective, depending on which particular studio is in rev share and which is not and which  
particular studio is hot from a new box office perspective and who is not. So to be explicit, if a particular studio has a rev share agreement  
with Netflix and that studio has a number of new release titles which are hot and that new content is being acquired in the form of rev  
share, those expenses will show up in the P&L and the cost of revenues. And conversely if there are a number of new titles from a studio  
which are popular and we're buying them outright, then that will show up in the statement of cash flows and content acquisition.  
   
Reed Hastings Netflix - Co-Founder & CEO  
Next question, direction of disc usage.  
   
Barry McCarthy Netflix - CFO  
I guess probably all these questions piled up. Stick with the same perspective of us not commenting specifically on usage.  
   
Andy Hargreaves Pacific Crest Securities - Analyst  
Will there be meaningful cost savings from the end of red envelope?  
   
Reed Hastings Netflix - Co-Founder & CEO  
No.  
   
Deborah Crawford Netflix - VP of IR  
Next question is from Derek Brown at Cantor.

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Derek Brown Cantor Fitzgerald - Analyst  
Recent article indicated the number of Roku units sold at about 100,000. Can you confirm that figure or say whether it's close? Can you  
provide any type of color on the behavior changes i.e. more digital, less DVD of Roku owning subscribers?  
   
Reed Hastings Netflix - Co-Founder & CEO  
No, we're not giving any comment on number of Roku sold. What was the second question?  
   
Barry McCarthy Netflix - CFO  
Behavior.  
   
Deborah Crawford Netflix - VP of IR  
Roku.  
   
Barry McCarthy Netflix - CFO  
Box owners.  
   
Reed Hastings Netflix - Co-Founder & CEO  
It's something we're starting to look at, but we have to be careful about overreading it, because the first people to buy Roku boxes of  
course are not typical people. So they're not necessarily representative of what we're going to see as that market expands. So while we're  
looking at it, we don't think it's particularly significant.  
   
Deborah Crawford Netflix - VP of IR  
Okay. Next question is from Brian Fitzgerald at B of A Securities.  
   
Brian Fitzgerald Banc of America Securities - Analyst  
With the previous announcement of the streaming service, Roku and LG, the service is naturally governed as there is a delay as this  
hardware gets deployed, with the X-Box being deployed at 12 million X-Box live subscriptions potentially at once. We have seen you  
doing full (inaudible) the acceptance traction on the X-Box. Can you give us a sense of the traction or speed of adoption you expect on the  
X-Box and any potential expenses around the big inflection in usage?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Yes, you're right, that there's a real step function there as Microsoft releases their update to the X-Box in the late fall. We think we're  
well-prepared for that, both in terms of the loads on our various servers and in terms of our financials and that's all built into our  
guidance.  
   
Brian Fitzgerald Banc of America Securities - Analyst  
You used to provide us with number of streams to date and we were hoping you could give us some kind of update on this.  
   
Reed Hastings Netflix - Co-Founder & CEO  
Yes, very early on we were disclosing number of streams. But we haven't -- what we tried to give investors some awareness of it, that the  
content investment is really to drive the number of partnerships and the number of seats of internet connected TVs and that's really the  
point of this aggressive early investment in content so that's why we're talking about the various deals that are signed and in process.  
And that's really the payback on this big content investment.  
   
Brian Fitzgerald Banc of America Securities - Analyst  
Last question from B of A. Amazon streaming VOD has a library of 40,000 versus Netflix's 12,000 in the Watch Now library. Can you  
explain to us what the major difference is between online pay-per-use 40,000 versus an online subscription model at 10,000 that would  
allow for one library to be so large relative to the other?

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Reed Hastings Netflix - Co-Founder & CEO  
I don't have a good answer for you on that yet. It's something we'll look at as we get to use the Amazon 40,000 more. Obviously YouTube  
has 400 million titles, but you have to think about the weight of the titles in some context. So a straight title count isn't probably a very  
interesting way to look at these things. The way we look at it for the Netflix service is providing enough content that subscribers are very  
excited about staying as a Netflix subscriber. So that's the basic subscription calculus. Again, we see the Amazon, Apple, pay-per-view  
model, the Hulu, ABC advertising supported model and the Netflix subscription model as three different segments of the overall internet  
video market.  
   
Barry McCarthy Netflix - CFO  
Having said that, I think the 40,000 for Amazon is an aspirational number that's been understood to be the current title count. I think  
actually the current title count is in the 5,000 range.  
   
Deborah Crawford Netflix - VP of IR  
From Michael Olson at Piper.  
   
Michael Olson Piper Jaffray - Analyst  
Is there any share repurchase factored into the guidance for the second half of '08 EPS?  
   
Barry McCarthy Netflix - CFO  
Yes, I mentioned -- probably Michael sent that in before my comments -- but we expect the weighted average share count to decline  
through the end of the year related to share repurchase.  
   
Deborah Crawford Netflix - VP of IR  
From Larry Witt at Morningstar.  
   
Larry Witt Morningstar - Analyst  
With Blockbuster on the sidelines for now, why not hold down the accelerator on marketing to gain more share?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Larry, it's Reed. I think I covered that just a moment ago, which is it's tempting but instead of doing that we are preserving our earnings  
guidance and it's one of those many balances of earnings and growth.  
   
Barry McCarthy Netflix - CFO  
This is Barry. Second point Reed previously made is that there are two ways to invest in growth. One is direct marketing spending, the  
other is the subsidy of lower prices and so in the third quarter last year we made a significant investment in incremental growth by  
lowering the pricing and only partially paying for it with reductions in marketing spending. So while we're all very enthusiastic about the  
reductions in marketing spending, we continue to cross-subsidize the business, if you will, with price reductions from a year ago.  
   
Deborah Crawford Netflix - VP of IR  
From Ken Smith at (inaudible).  
   
Ken Smith - Analyst  
What was the Bay Area household penetration and rest of country penetration?  
   
Reed Hastings Netflix - Co-Founder & CEO  
The Bay Area penetration was up 20 basis points to 18.8% from 18.6% and rest of country was up 20 basis points from 7% to 7.2% in the  
end of Q2.  
   
Deborah Crawford Netflix - VP of IR  
From Michael Pachter at Wedbush.

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Michael Pachter Wedbush Morgan Securities - Analyst  
Microsoft told us that in surveying its X-Box live membership it felt that just under 1 million of its customers were Netflix customers. Have  
you conducted a similar survey?  
   
Reed Hastings Netflix - Co-Founder & CEO  
No, we don't have access to the Microsoft user base, so are unable to do that survey, Michael. And whatever the current numbers are, it's  
more interesting thinking about the potential, both as Microsoft markets the Netflix service to get LIVE Gold upgrades and also to sell  
consoles against their competitors and as we advertise the X-Box console as a way to get instant streaming. So we're mostly excited not  
about the current installed base but about the future overlap that we can both generate.  
   
Deborah Crawford Netflix - VP of IR  
From Larry Witt at Morningstar.  
   
Larry Witt Morningstar - Analyst  
What are your expectations for future capital expenditures on technology regarding the Watch Now service? And do you plan on  
providing better quality streaming in the future and what are the implications of additional spending on this?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Yes, we're continuing to improve the quality of the streaming but not using our own capital. Mostly it's through better use of the CDM  
market, better integration with the CDMs, better monitoring, so that's how we're achieving that. So it's a straight P&L model as opposed  
to anything capitalized or on the balance sheet.  
   
Deborah Crawford Netflix - VP of IR  
From Derek Brown at Cantor Fitzgerald.  
   
Derek Brown Cantor Fitzgerald - Analyst  
Can you help us understand the framework of the digital content deals you are striking? Are they pure revenue share? Are there  
substantial upfront costs you are incurring for first time access to the content?  
   
Barry McCarthy Netflix - CFO  
Derek, Barry. We are trying to be purposely vague in responding to that question, which I know continues to be frustrating for you. The  
content deals in some respects at a high level are similar to DVD, meaning there's some revenue sharing and there's some fixed fee  
payment. Now, if you -- so let's see. From a P&L perspective, if the service were to grow at, say, twice the rate of adoption that we are  
projecting, the obvious concern on the part of investors and the management team would be that P&L expenses would run away from us  
and we would badly miss our guidance. And we've been mindful of that in our negotiations with studios for content deals and I don't  
anticipate that happening.  
   
Deborah Crawford Netflix - VP of IR  
From Lloyd Walmsley at Thomas Weisel Partners.  
   
Lloyd Walmsley Thomas Weisel Partners - Analyst  
Your competitors have been paying about 50% rev share splits in physical rentals. What are you seeing from studios in terms of  
increasing splits in rev share? How often are rev share terms negotiated with studios? If you have been seeing increasing rev share costs,  
how has this impacted gross margins? If not, how might this going forward if pricing were to increase for you in rev share?  
   
Reed Hastings Netflix - Co-Founder & CEO  
We haven't seen any material change in the rev share climate for our purchasing so we're continuing to build our library and our  
relationships with studios. So no material change there.

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Barry McCarthy Netflix - CFO  
This is Barry. As compared with the brick and mortar world, we have a much higher percentage of content that's purchased outright than  
rev share, because we have the luxury from a free cash flow perspective of being able to acquire the content outright. So we're -- if that  
phenomenon were to emerge in our world, then probably it would have less of an impact on P&L than it would be if we had a very high  
percentage of content acquired on rev share.  
   
Deborah Crawford Netflix - VP of IR  
I believe this is our final question. If anybody has additional questions please e-mail them to dcrawford@netflix.com. The question I have  
is from Daniel Leonard.  
   
Daniel Leonard First Analysis Securities - Analyst  
Can you speak further on share buyback program and when you can initiate purchases again?  
   
Barry McCarthy Netflix - CFO  
Well, we can initiate purchases when the window opens. The window will open on Monday absent a particular transaction that would  
require the Company for legal reasons to, because it possesses material non-public information, to not participate in the market and, if  
we were to possess that information, of course I wouldn't comment on it. But I expect that the window will open Monday.  
   
Barton Crockett JPMorgan - Analyst  
Another question from Barton Crockett at JP Morgan. Blockbuster is showing a beta version of new download service Movie Link. Can you  
talk about how that compares to your service?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Barton, I haven't used the new Blockbuster service. So I'm just going by the press reports and from being a customer of Movie Link and  
Movie Link is a pay-per-view model, so it competes with Amazon or Apple in that segment. So I imagine they've done a good job. Movie  
Link had been well-implemented before. So we look at it and say it's another pay-per-view service and that's fine. It's just not in our  
segment.  
   
Deborah Crawford Netflix - VP of IR  
Final question from Ryan Hunter.  
   
Ryan Hunter - Analyst  
You mentioned DVD kiosks having a competitive impact on DVD stores. How do you see this model impacting Netflix?  
   
Reed Hastings Netflix - Co-Founder & CEO  
Ryan, something that we've looked at extensively, using the areas of the country that have high kiosk penetrations, would be where and  
how it affects Netflix and we haven't yet been able to detect any change in those areas. So we're relatively comfortable that as kiosks  
grow, it doesn't present a direct threat to our business. We'll continue to watch that. It's still early in the DVD rental kiosk market, but  
obviously the secondary benefit will come later which is with accelerated store closures which will help us.  
   
Deborah Crawford Netflix - VP of IR  
I believe that's the last question. Thank you everybody.  
   
Reed Hastings Netflix - Co-Founder & CEO  
With that, let me thank everyone for joining us for this early morning call and look forward to talking to you all next quarter.

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Reed Hastings Netflix - President and CEO  
   
Barry McCarthy Netflix - CFO and PAO  
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Brian Pitz Banc of America Securities - Analyst  
   
Youssef Squali Jefferies & Company - Analyst  
   
Barton Crockett JPMorgan Chase & Co. - Analyst  
PRESENTATION  
   
Operator  
Good day, everyone, and welcome to the Netflix Third Quarter 2008 Earnings Conference Call. Today's call is being recorded. At this  
time, for opening remarks and introductions, I would like to turn the call over to Deborah Crawford, Vice President of Investor Relations.  
Please go ahead, Ma'am.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Thank you and good afternoon. Welcome to Netflix's third quarter 2008 earnings call. Before turning the call over to Reed Hastings, the  
Company's co-founder and CEO, I will dispense with the customary cautionary language and comment about the Webcast for this  
earnings call.  
We will 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 28, 2008.  
We released earnings for the third quarter at approximately 1:05 PM Pacific time. The earnings release, which include the reconciliation  
of all non-GAAP financial measures to GAAP and this conference call, are available at the Company's Investor Relations Website at  
www.netflix.com. A rebroadcast of this call will be available at the Netflix Website after 5 PM Pacific time today.  
Finally, as we noted in the press release we issued earlier today, we are going to conduct the question portion of the Q&A via e-mail.  
Please e-mail your questions to me at dcrawford -- D-C-R-A-W-F-O-R-D -- @netflix -- N-E-T-F-L-I-X -- .com. And now I would like to  
turn the call over to Reed.  
   
Reed Hastings Netflix - President and CEO  
Thanks, Deborah, and welcome, everyone. I'll talk briefly about Q3 and then turn to what I imagine is on everyone's mind -- namely, how  
the recession will affect Netflix.  
In Q3, we added 261,000 net subscribers, down 9% on a year-over-year basis, while our total subscriber base grew to us 8.7 million, up  
23% from a year ago. Our EPS was strong at $0.33, up 43% from $0.23 one year ago.  
We continue to improve the Netflix service by adding more content that can be watched instantly on PCs and TVs. We are now up to more  
than 12,000 choices and with the recent addition of content from Starz, CBS and Disney Channel have increased the strength of our  
offering materially.  
In Q3, we were very happy with a sales momentum of the $99 Roku device, which provides an inexpensive method for instantly streaming  
movies and TV episodes from Netflix to the television. Additionally, in early October LG Electronics released the BD300 -- the first  
Blu-ray player to include instant streaming from Netflix.

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Part of our long-term strategy is to get our streaming client embedded in as many Blu-ray players as possible. LG Electronics was our  
first such partner. And we will announce more Blu-ray partnerships as they are ready for consumers.  
In addition to getting embedded in Blu-ray players, our partnership with Microsoft Xbox will help us gain more traction with consumers.  
Next month, Microsoft will release a free software upgrade for all Xbox 360 users that includes instant streaming from Netflix.  
Xbox 360 owners will have to connect their console to the Internet and join the $50 per year Xbox Live Gold in order to access Netflix  
streaming. We will know more about its successes and potential a few quarters after it launches.  
While our initiatives to deliver content to the TV are gaining real momentum, consumer comfort with watching video on a laptop is also  
growing. So we are continuing to invest in improving laptop-oriented streaming from Netflix.  
This quarter, we will begin the rollout of our second generation player software which runs both -- which runs on both Windows and Intel  
Macs. It is a huge step forward for online video players; and we will be announcing the details shortly.  
Two of the most significant events in the quarter were our deal to distribute the Starz play content and Starz's separate decision to close  
Vongo. Starz is a very successful subscription content wholesaler, who had been operating a direct-to-consumer extension called Vongo.  
Until recently, it looked like we might -- in a streaming world -- end up competing with the pay television networks going  
direct-to-consumer. Since they have the major studios new release content locked up on long-term exclusive deals, this would have led  
to a very fragmented set of consumer options and slowed the adoption of Internet delivery. So this pivot, where Starz distributes hits  
Starz play service through Netflix, is very significant.  
Our value ad is in our Website, in our on-demand streaming model and in our linking with DVD rental. With this new model, we think we  
can generate increased profits for Starz, increased profits for Netflix and, over time, for the studios.  
Now, on to the impact of the recession on our business. A quarter ago in July, I told you that we appear to be substantially unaffected by  
the been economic climate.  
Since July however, the economy has deteriorated markedly. It now appears that the recession means continued subscriber growth for  
Netflix, but not as fast as last year. This quarter to date, our net ads are positive. In other words, we are growing but our net and so far  
this quarter are about 30% less than one year ago.  
For reference, our Q4 subscriber guidance is for our net ads for the fourth quarter to be between 60% below last year net ads on the  
low-end to 6% above last year's net ads on the high-end. The good news is that our earnings in Q4 will come largely from existing  
subscribers and not from new subscriber growth. So Q4 earnings are substantially insulated from the current climate.  
This is the real power of the subscription model. If there is any effect from slower growth now, it would be more likely to boost Q4  
earnings than to shrink them. A small contributor to earnings in Q4 will be our $1.00 per month surcharge for those subscribers who  
have elected to enable access to the more expensive Blu-ray high-definition content.  
We expect to have about 0.5 million Blu-ray enabled subs during this quarter. And this number will grow over time as Blu-ray player  
prices fall from $500 to $300 and below.  
In summary, we are in the midst of challenging times that have shaken consumer confidence across the country. But the fact is that  
people continue to be attracted to the Netflix service and our business continues to grow, in both subscribers and earnings.  
While the economic environment is out of our control and volatile, what is in our control is executing on our strategy, delivering great  
service with DVDs and instant streaming, and remaining flexible in a fluid environment.

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At this point, I'll pass it over to Barry.  
   
Barry McCarthy Netflix - CFO and PAO  
Good afternoon and thank you for joining today's call. Two weeks ago, we preannounced Q3 results in our Q4 guidance.  
As you know from today's earnings release, Q3 results were in line with our preannouncement. Today's release also updated our  
subscriber and revenue guidance for Q4 which I will say more about in a moment.  
As we discussed, sub growth slipped below our expectations in Q3. And that is disappointing news. The good news is that, in a difficult  
economic environment, which contributed to slower-than-expected subscriber growth, we managed to grow subscribers by 23%  
year-over-year. And Q3 financial results demonstrated that our business model is healthy and functioning well.  
In Q3 we continue to effectively manage our cost structure and delivered healthy earnings as profit margins expanded 70 basis points on  
a year-over-year basis. Net income grew by 30% year-over-year to $20.4 million and EPS grew by 43% year-over-year to $0.33. This  
represents an acceleration of growth in both net income and EPS on a year-over-year and a sequential basis.  
With free cash flow of $26.2 million in Q3, the second-highest quarter of free cash flow in our history, with $251 million in cash and  
short-term investments, and with a pristine balance sheet, the business is well positioned from a financial standpoint to continue to  
execute on core strategic objectives for growing the business. Reed summarized those objectives on our last earnings call when he said  
our goal at Netflix is to materially grow subscribers and EPS every year, while expanding the unlimited DVD by mail service to also  
include unlimited Internet streaming.  
My remarks today will focus first on our Q3 performance. Second, I will comment on our Q4 guidance. And, lastly, I will update you on the  
progress of our stock buyback efforts last quarter.  
Because Reed has already commented on subscriber growth, my comments will address the other key drivers of financial performance  
last quarter. With respect to Q3 results, gross margin was an important contributor to strong earnings.  
On a Q over Q basis, gross margin increased by 240 basis points higher than we had initially expected. The primary contributor to margin  
growth was lower content costs, reflecting a seasonally weak near-release calendar. We saw that weakness play out in the mix of near  
release versus catalog shipments with catalog shipments reaching an all-time high as a percent of total shipments last quarter.  
DVD usage was in line with our expectations last quarter. We have not and we are not seeing increased levels of DVD usage as  
consumers trend discretionary spending outside the home, in response to economic pressures.  
Churn for the quarter was 4.2%, the same as it was in Q3 of last year and in Q2 of this year. While we are pleased the churn did not  
increase, we had expected the aging of our subscriber base to produce a slightly lower churn rate in Q3. The state of the economy may  
explain the modest headwind we have experienced with churn in Q3, and expect to experience in Q4, given the economic climate.  
And now a word about SAC. Q3 saw the first increase in the last six quarters. That is the bad news.  
The good news is that SAC declined [to] 15% on a year-over-year basis which means our economic model remains healthy. And we've  
maintained our financial discipline, as we continue to grow the subscriber base.  
The primary reason for the increase in Q3 SAC was the decline in acquisition rates across all channels, including word-of-mouth. Once  
again, likely attributable in large part to the economy.  
Earlier in my remarks, I commented on our strong balance sheet. And I want to spend a moment talking about the composition of last  
quarter's cash and short-term investments which totaled $251 million at quarter end, 62% of which was held in cash, commercial paper  
and US government and agency paper.

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We have no exposure to the sub-prime workers market and limited exposure in the asset-backed market. Our portfolio is conservatively  
invested and appropriately guided. And notwithstanding the substantial disruption in credit markets, I think we're in pretty good shape.  
Today's earnings release lowered our Q4 guidance for ending subscribers and revenue. As Reed mentioned in his remarks, like everyone  
else, we are concerned about the state of the economy; the impact on overall consumer spending; and the economy's impact on our  
growth rate.  
However, on balance, we are generally optimistic about our relative growth prospects in the current economic environment, because  
Netflix offers consumers a great service and a good value. And we remain confident we can manage spending and meet our Q4 earnings  
goals like we did in Q3. By continued deterioration of the economy in general and consumer spending in particular could slow the rate of  
subscriber growth.  
Finally I would like to update you on the status of our stock buyback program. In March of this year, we announced an additional share  
repurchase program of $150 million. This past quarter we repurchased three million shares at the average cost of $30.09 per share,  
which leaves $60 million available to buy back additional shares under the current authorization.  
Our Q3 buyback raised our cumulative share repurchases to 11.6 million shares at the total cost of $290 million and an average cost of  
$25.06 per share.  
In closing, we believe the fundamentals of our business model are sound. Our expense structure is appropriately sized to manage our  
planned growth as well as our strategic objectives, even in these uncertain times. We are fortunate that our business continues to  
generate strong free cash flow and that our balance sheet remains healthy.  
That concludes my prepared remarks. Now it's time to answer your questions.  
As Deborah mentioned at the beginning of our call, we would like you to e-mail your questions to dcrawford@netflix.com as you did last  
quarter. Deborah will read the questions out loud and Reed and I will do our best to answer to them.  
So, Deborah, over to you for the first question.  
QUESTIONS AND ANSWERS  
   
Operator  
(Operator Instructions). Mark Mahaney with Citi.  
   
Mark Mahaney Citi - Analyst  
A cost question. In a severe recessionary environment, subscription models should hold up well. But in a very limited growth scenario,  
severe recessionary, very limited growth scenario, how much leverage do you have over all the cost items?  
In other words, with almost no record growth can you still deliver material earnings growth? Thank you.  
   
Barry McCarthy Netflix - CFO and PAO  
If we maintain our spending discipline at the subscriber level from acquisition standpoint, then we've got a fair amount of leverage. And I  
am highly confident. We've never lost that discipline, but if we did and we could -- a short thesis on the business has always been that  
marketing expenses would spiral out of control, and the margins on the business would implode.

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So we use a macroeconomic model. It informs us about the lifetime value of the subscriber. We limit the amount of money we are willing  
to spend at the margins to acquire a subscriber with the knowledge of lifetime value, which is why I'm pretty confident that we will  
remain disciplined in terms of how much we are willing to spend at the margin to acquire a sub.  
   
Mark Mahaney Citi - Analyst  
Thank you Barry.  
   
Barry McCarthy Netflix - CFO and PAO  
So all of the other costs of business, essentially, we think of as variable. Although that is not entirely true. For instance, the depreciation  
expense on acquired DVDs is not exactly a variable expense.  
But the postage and the packaging and the direct labeler all variable expenses associated with getting DVDs out the door. Then the  
other big expense item are heads.  
So if you can control your marketing spending at the margin and you control your fixed costs around headcount, you pretty much have  
your arms around the business. Provided of course you continue to provide a good service, subscribers remain happy, and they stick with  
you.  
Now since more than half of our subscriber base has been with us for more than a year, it would take an enormous shock to the consumer  
ecosystem for the majority of our subscriber base to blow up and leave the service. Not likely to happen.  
   
Mark Mahaney Citi - Analyst  
More shock than we have seen already?  
   
Barry McCarthy Netflix - CFO and PAO  
More shock than we have seen already.  
   
Reed Hastings Netflix - President and CEO  
Who's next? Anyone?  
   
Operator  
Brian Pitz with Banc Of America.  
   
Brian Pitz Banc of America Securities - Analyst  
Just a quick follow-up. Any additional color on the onetime charges this quarter? Thanks.  
   
Barry McCarthy Netflix - CFO and PAO  
I described them as onetime charges. And then I said you could count on seeing them on an ongoing basis and I'm sure I sounded like a  
fool. Least I felt like one.  
The majority of the expense savings in G&A related to the decision to exit the Red Envelope business. That will be ongoing savings. There  
was a smaller onetime charge that was associated with Corporate Events that goes away. But the majority of the savings, I think, will be  
with us on a go forward basis.  
   
Operator  
Youssef Squali of Jefferies & Co.  
   
Youssef Squali Jefferies & Company - Analyst  
Thank you very much, great job. So as you conduct to these exit reviews with customers online, I was wondering if you noticed any pickup  
in people maybe leaving Netflix to go to the cheaper alternatives like the Red Boxes of the world?

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I think historically you've talked about how I guess a year and a half ago or two years ago they [weren't] (inaudible) radar screen and the  
last six to 12 months they became more relevant. Where do they sit right now?  
   
Reed Hastings Netflix - President and CEO  
The Red Box has increased in those exit surveys. But when we look at certain areas of the country have very high Red Box penetration.  
And when we try to see if we can see any increased churn in those areas relative to areas that don't yet have kiosks, we are unable to  
detect any change in the underlying retention.  
So it seems to me that it's a substitute for the stores. That it's the same people were leaving, but they are going to go to the kiosk instead  
of a store as opposed to something that inflates our churn.  
   
Youssef Squali Jefferies & Company - Analyst  
Okay. Thanks.  
   
Operator  
Barton Crockett with JPMorgan.  
   
Barton Crockett JPMorgan Chase & Co. - Analyst  
Thanks for taking the question. I will try to clarify the one that I mangled in the email. What I was trying to get at is, with the $1.00 extra  
you are charging for the Blu-ray availability, you know it is basically charging people for something that they used to get as part of their  
standard subscription.  
So what I'm trying to figure out is, in your view of it, does that extra $1.00 result in basically slowing subscriber growth, because people  
are having to pay more for something they used to get as part of the standard feature or increasing churn? Or does the opposite happen?  
Do you use that extra $1.00 charge to buy more product, make it a better service and improve subscriber growth and lower churn?  
   
Barry McCarthy Netflix - CFO and PAO  
You imply that doing the $1.00 surcharge is like a takeaway or something to the subscriber base, but almost none of the subs had a  
Blu-ray player. So to them, they were never introduced to the feature.  
The vast majority of our subscribers will only ever know Blu-ray as the $1.00 surcharge in this brief intro period that we had for the last  
nine months where it was too small to even figure out how to charge someone. You know, it will be inconsequential.  
So I think when you look at local videos store, they tend to only charge a $1.00 more for the Blu-ray rentals. High-definition content table  
and otherwise and on the Internet cost more. So it will seem completely natural to the subscribers that the Blu-ray high-definition  
content has a small premium attached to it.  
   
Barton Crockett JPMorgan Chase & Co. - Analyst  
That's helpful. And then a follow-up question, if I could.  
What is going to be the gross margin impact of that higher price? Is it [going] to be offset with more spending on Blu-ray product or is it  
actually going to be something that boosts the gross margin?  
   
Reed Hastings Netflix - President and CEO  
We kept our Blu-ray stock levels at pretty good shape for the last six months and we will continue to go on. I think it will be very slow as  
we get from 0.5 million to 1 million subscribers. It will ease in over time.  
As to whether in the end it's positive or negative to current gross margin it's positive or negative to DVD economics is uncertain. It  
depends on the pricing of DVD movies compared to Blu-ray movies. And we are unsure if the current Blu-ray pricing, which is a  
considerable premium, will sustain as that becomes a mass product. You'll probably recall from DVD in its entry 10 years ago that it

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started off premium priced and then came down.  
So it's a bit of an open question on what's going to happen with Blu-ray software.  
   
Barton Crockett JPMorgan Chase & Co. - Analyst  
That's great. Thanks a lot.  
   
Operator  
There are no further questions at this time.  
   
Reed Hastings Netflix - President and CEO  
Great. Well, thank you, everyone, for joining us on the call and I look forward to talking to you, with you again in a quarter.  
   
Operator  
That does conclude today's conference. We do thank you for your participation. You may disconnect at this time.  
QUESTIONS AND ANSWERS  
   
Deborah Crawford Netflix - VP of Investor Relations  
The first question comes from Colin Sebastian at Lazard Capital Markets. Can you please comment on pricing trends in your online  
marketing spend [so] it's on search and display ads?  
   
Reed Hastings Netflix - President and CEO  
We haven't seen any material softening of those rates, such that it would improve our efficiency where we are watching the trends and  
hopeful of that from our sake as the buyer of such. But nothing is broken yet.  
   
Deborah Crawford Netflix - VP of Investor Relations  
The next set of questions comes from Youssef Squali of Jefferies.  
First -- can you speak to usage during the quarter? Is there a way to parse that lower usage from the Olympics/blackout in August versus  
the effective lower-priced plan?  
   
Reed Hastings Netflix - President and CEO  
Short answer is no, not really.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Second question -- as we looked at fiscal year '09 knowing what we know today about the economy and and the consumer, do you expect  
the year to be better or worse than '08 in terms of customer add?  
   
Reed Hastings Netflix - President and CEO  
That depends quite a bit on the economy. So, normally, we expect a relatively similar economy to what we currently have. And I think for  
obvious reasons it's not healthy at this point so we will be able to update you on '09 in January.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Next from Brian Pitz at Banc Of America Securities.  
We have seen a sharp drop-off in the retail sector in late August and September even impacting other online names such as eBay. We  
were hoping you would comment on subscriber adoption trends in September/October versus July/August, particularly since you have  
lowered [sub] guidance in the past two weeks. We see that October is much worse than previous expectations.

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Reed Hastings Netflix - President and CEO  
In my comments -- probably the question was sent in before the comments, for the first time we broke out what we've done in the first  
part of October. So for the first three weeks of October we're trending approximately 30% below a year ago in terms of growth, in terms  
of net additions. So our growth is positive and it's 70% as big as one year ago October.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Next also from Brian Pitz at Banc Of America Securities.  
Will the Starz (inaudible) significantly higher costs than your existing online content? In part because the titles appear to be new releases  
and less "longtail". Can you tell us anything about this idea or perhaps if the model is a rev share versus fixed fee versus something else?  
   
Reed Hastings Netflix - President and CEO  
We don't break out details of the contract, but all of the costs of it are built into our guidance for the quarter.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Michael Olson at Piper Jaffray -- why was G&A so low? Is that sustainable?  
   
Reed Hastings Netflix - President and CEO  
Michael, there are a number of onetime events in the quarter. The largest of which was our decision to exit Red Envelope business and  
those reduced our -- on an ongoing basis and spending levels in Q&A.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Also from Michael Olson -- what is the percentage of customers using Watch Instantly? Have you seen a drop-off in DVDs by mail for  
those customers?  
   
Barry McCarthy Netflix - CFO and PAO  
We've seen a growing adoption of the Watch Instantly as we've got more platforms and more contact and expect that to continue. You  
can't really see a drop-off in DVD usage, because the people who go for online streaming are a different type of person.  
So there's no good control of what those people would have done. So there's no easy way to tell that. What we are feeling good about is  
with the new Starz content, the breadth of what we have from Disney Channel is we are getting more and more watching which is exactly  
what we're aiming for.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Jim Friedland at Cowen, what drove the sequential increase in SAC? Was it related to the macroenvironment?  
   
Reed Hastings Netflix - President and CEO  
As I said in my comments, there were two effects in the quarter and one is that response rates were down. And secondly we saw less by  
way of word-of-mouth growth than we thought we would. So the mix of free versus pay was lower than we thought it would be in the  
quarter, which contributed on average to higher SAC.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Also from Jim Friedland, DVD purchases are down 2% year-over-year for the first nine months of the year. Are subscribers watching less  
content due to the aging based our is the mix shifting to revshare?  
   
Barry McCarthy Netflix - CFO and PAO  
That varies quarter to quarter, and because the revshare mix is fluid as -- both as studios which in or out of revshare or as studios with  
revshare have a hot hand. You really can't get a read by just looking at the -- essentially the CapEx on it. So overall I would say it is pretty  
steady, which would be our spending.

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Deborah Crawford Netflix - VP of Investor Relations  
From Barton Crockett at JPMorgan, regarding the Blu-ray price hike, the idea of percent uptake price hike offset by more products  
purchases. Does it help ARPU potential for offset and lower subscriber growth and higher trends from price sensitivity? Or the opposite --  
lower churn, better subscriber growth because of more product?  
   
Barry McCarthy Netflix - CFO and PAO  
Could you summarize that, Deborah? I think the question is, what's the overall impact from Blu-ray adoption? And the answer is, remains  
to be seen. There's still a relatively small percentage of the subscriber base signed up for Blu-rays. Reed mentioned them in his remarks  
and we think it would be still relatively small come year-end.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Well okay.  
   
Barry McCarthy Netflix - CFO and PAO  
Deborah's going to clarify.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Barton, if you have a clarification, would you please e-mailed to me and then I'll get to it. Let's go on to the next one also from Barton  
Crockett. What was the gross margin impact of the $6.5 million service credit? Did usage go down? Is it sustainable?  
   
Barry McCarthy Netflix - CFO and PAO  
Usage did go down because, during the shipping interruption, we didn't ship DVDs. We have a rough estimate of what the impact on  
profit is, but it's hard to know.  
So I don't consider it to be a contributor to higher gross profit in the quarter. Probably the opposite, but it's just -- it would be an -- it's an  
estimate [on my part].  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Michael Pachter at Wedbush, could you please explain the new pricing plan for Blu-ray access with a simple answer? Is the price  
increase going to be implemented for all subscribers, requiring those who prefer to pass on the Blu-ray opportunity to opt out? There is  
some confusion as to whether the pricing is opt in.  
In other words subscribers who choose Blu-ray will be charged, but those who did not affirmatively choose Blu-ray will be not charged or  
opt out as described above?  
   
Reed Hastings Netflix - President and CEO  
It's opt in. So if you want Blu-ray, you go through an additional sign up as a member saying I would like Blu-ray and we say it's an extra  
$1.00 and you say yes or no.  
The only case where it was opt out, which is what generated the confusion, was Blu-ray used to be a free option. And of those who had  
prior signed up for Blu-ray, they have an opt out of the Blu-ray status if they don't want the charge. And that is what generated the  
confusion.  
But for the general subscriber, going forward 8.6 million, it's opt in.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Andy Hargreaves of Pacific Crest, was there a limit or what was the linearity of churn? Did more people leave late in the quarter?

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Reed Hastings Netflix - President and CEO  
No material change from -- there's normal seasonal patterns that we see. But there was no significant pattern, for example, related to  
the economy that we saw during the quarter.  
   
Deborah Crawford Netflix - VP of Investor Relations  
And a similar question, also from Andy Hargreaves, the linearity of gross additions. Was it front-end loaded or consistent?  
   
Reed Hastings Netflix - President and CEO  
As we announced in our prerelease of the numbers, in August -- presumably due to the Olympics and to our shipping outage -- net  
additions were light which is mostly steady churn. So it's really lights in gross additions.  
We think from the distraction of the Olympics and then September was relatively more strong. So it doesn't tie into the overall retail  
thesis of things getting worse and worse. And I think the Olympics was a special effect for us in terms of consuming viewing hours, thus  
obscuring the underlying economy.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Doug (inaudible) at Barclays Capital, you've typically said you grow earnings in the middle of the pack of Internet companies. But  
given the macro environment and even exchange, that tax growth rate will seemingly come down over the next 12 to 18 months.  
Is it reasonable to think you are still in the middle of backpack in 2009 or do you think you can outperform?  
   
Barry McCarthy Netflix - CFO and PAO  
Hard to know. As Reed pointed out in his comments, the nature of the subscription business is that it's positioned well, to weather the  
store of an economic downturn as compared with revenue stream that's essentially non-recurring.  
So we have a lot of optimism about our ability to sustain near-term profits. And it's hard to imagine that there would be a significant  
sharp downward departure from the overall trend line in earnings growth and that remains to be seen what happens to new subscriber  
growth on a go forward in reaction to the economic environment. But as I said in my comments, overall, we are pretty optimistic.  
So we will provide guidance for '09 on a January call. I haven't specifically answered your question, but I'm trying to indicate at least of  
our frame of mind as we are thinking about prospects for '09.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Also from Doug at Barclays, what are you optimizing more for in tough environments between subscriber growth and earnings growth?  
Same balance as before? And what does that mean for subscriber acquisition costs going forward. You've spent more this quarter, but  
you've generally pulled back.  
   
Reed Hastings Netflix - President and CEO  
I would say our balance between earnings growth and subscriber revenue growth and our thinking on that has not changed materially. If  
the economy changes materially over the next couple quarters, it might have to be something we would look at.  
But assuming that it's no worse than today than, as Barry said, the power of the subscription model then that gives us stability through  
these otherwise turbulent areas.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From [Mark McHaney] at Citigroup, how can Netflix be confident that soft subscriber additions are due to economy and not due to  
alternative or competition or maturation of the market? Do you have any customer surveys to prove this point?

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Reed Hastings Netflix - President and CEO  
I'm not sure a customer survey would really prove it to you, surveys being as general as they can. It's definitely something that we think  
about which is, is it really economy or is it something else? We try to really tease apart the various competitive alternative hypotheses.  
And at this point it strongly points towards economy from a range of sources, but it is something that we keep an open mind about.  
   
Barry McCarthy Netflix - CFO and PAO  
I wonder (inaudible) perspective. You know there's this saying goes something like this -- what you see is a function of where you sit. And  
where we sit right now, having underperformed the low end of our guidance expectations for the quarter and lowered our expectations  
for Q4, it looks like the business is dramatically slowing. It feels like we are underperforming.  
On the other hand if we were to step back to say, January of 2008 when our year-end subscriber guidance was 8.4 million to 8.9 million,  
we realize that, gee, at the end of the third quarter of the year we had more subscribers than we were expecting to have at year-end. And  
in January of this year we weren't taking questions about whether or not the market would saturate it.  
So on a what you see is kind of a function of where you sit, I realize that it feels like the economy is slowing, slowing, slowing; and it raises  
some concerns about future growth prospects for the business. But as little as nine months ago, been ecstatic about finishing the third  
quarter with more subs than we were forecasting to finish the year with.  
So let's don't push the panic button. Have a little perspective on where we are. Overall the business is doing pretty well.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Larry Witt at Morningstar, if Starz is free to distribute the content they buy from studios in any form they want, when does the  
studios prefer to deal with Netflix directly?  
   
Reed Hastings Netflix - President and CEO  
You know, Starz -- we are not privy to what their contracts are with the studios. And the studios would prefer to get a lot of money for  
their content. If Starz pays them a lot of money, for -- for example -- Internet distribution rights, there's no inherent reason why the  
studios want to deal with us.  
So in the current deal, Starz has those rights. They paid for those rights. And it makes sense all around to build that market.  
We, in addition to the Starz deal, have lots of other content in the Starz deal. It's about 2500 titles in total. And we have over 10,000  
other titles that are direct with the studios.  
So we are flexible. And we will work in both ways.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Ingrassia at Roth, what indications do you have, if any, that mainstream consumers are willing to pay a premium for the streaming  
option or for Blu-ray?  
   
Reed Hastings Netflix - President and CEO  
On Blu-ray, we are charging a premium and we expect to have about 0.5 million subscribers of the 8.6 million. So we have that  
indication.  
In streaming we don't have any hard indication yet, because we don't have a surcharge on it. Generally, people are willing to pay for what  
they're active users of and don't want to pay for what they're not using. So the focus for now in the first stage of this is getting the usage  
up, which is really driven by the content expansion and the platform expansion.  
If we are successful on those as we have been in expanding from 2000 titles a year and a half ago to 8,000 to 12,000 titles now to  
continuing our platform expansion, then I think we are really creating consumer value, which will be able to be monetized.

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Deborah Crawford Netflix - VP of Investor Relations  
Also from Rich, what happened to the deferred tax asset? Why did this line more than double sequentially?  
   
Reed Hastings Netflix - President and CEO  
I will have to take that off line. I will get back to you. If it's off the top of my head, I'm not sure.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Dan Ernst at Hudson Square, Blu-ray. Any reduction in Blu-ray usage after the price cut? What did your outlook for Blu-ray titles  
selection currently rather spend less than 1000 titles?  
   
Reed Hastings Netflix - President and CEO  
While Blu-ray is [sitting] on a total titles count, on a weighted basis it is pretty strong because there's Blu-ray for all of the new releases  
at this point. So you know we are optimistic player prices are falling, they are starting to get some volume.  
It's the same cycle that we really have seen on DVD. And I think what we will see is like a progressive scan, was a feature that was only in  
high-end DVD players and then became a feature in low-end DVD players. And after that was upscaling with H DMI out. That was a  
feature on high-end DVD players and then migrated to the middle of the market and into the basic models.  
To think of Blu-ray partially as a player is just a new better, upscaling player and as prices come down, people who even are just DVD  
watchers are going to get a Blu-ray player because the prices are low and it upscales the DVD very nicely. So we are really pretty  
optimistic as prices come down on Blu-ray players replacing DVD players.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Also from Dan Ernst -- digital content acquisition. Title selection numbers moving up, but still there are very few of the Netflix 100 as a  
point of reference that have the digital options. What is the outlook for adding more popular titles and what are the key obstacles to  
adding more titles?  
   
Reed Hastings Netflix - President and CEO  
The key obstacles are really money. The titles are available but expensive. And what we have to do is grow the ecosystem of embedded  
players that connect to the TV so that we can monetize the content expenses.  
So what we see is we have steady increase in the number of players and devices. They can access the Netflix content, steadily increasing  
adoption on the laptop viewing and on both Intel Mac and the PC.  
And along with that, we will growth the title count. As I mentioned earlier, in the last 18 months we've grown it from 2,000 titles to over  
12,000. So we know there's a long way to go. It's going to take many years. But we think we are doing -- making great progress on that  
and we will continue to do so.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Barton Crockett at JPMorgan, how much cash do you believe you need to maintain on the balance sheet to be comfortable in this  
economic environment?  
   
Barry McCarthy Netflix - CFO and PAO  
Well we have a point of view about that. And I think we will keep it to our sales in order to have maximum amount of flexibility.  
   
Reed Hastings Netflix - President and CEO  
And we've been cash flow positive every year for the past six or seven years, including during our big battles with Blockbusters. So -- .  
   
Reed Hastings Netflix - President and CEO  
As long as we have been public.

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Barry McCarthy Netflix - CFO and PAO  
As long as we've been public. So consuming cash is quite unlikely.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Lloyd Walmsley at Thomas Weisel Partners, can you please discuss trends and content acquisition with regard to both digital and  
[physical] content? Specifically your DVD CapEx growth of 5% this quarter is much lower than ending subscriber growth of 23%.  
Is the shift you mentioned to more catalog shipments sustainable going forward or more of a quarterly specific trend? As we look to  
2009, if we expect a digital product to draw strong subscriber growth and digital content consumption in 2009, should we assume that  
there is some pressure on growth margin offsetting the revenue gains of subscriber growth?  
   
Barry McCarthy Netflix - CFO and PAO  
I think there are two -- I heard two of what I think are two questions. So correct me as I go. One relates to content purchasing which we  
had already addressed and then the mix between and the implications of revshare for CapEx.  
And as Reed pointed out, it changes from time to time depending on which of our studio partners has a hot hand. And at the moment we  
have a large studio partners and revshare deals just got a hot hand.  
And then I think the second part of the question relates to DVD spend -- I'm sorry, ED spending, whether or not increased spending on  
ED over time will create [large end] growth margin pressure on the business. And the answer is in two parts.  
One, as Reed had said previously, we are in investment mode in ED world from a content perspective into 2010. And, secondly, at some  
point investments we are making in improving our (inaudible) service, we expect to earn the return on, either in the form of lower return  
or lower SAC because of higher organic growth or both or none of the above. In a failure scenario -- obviously we are planning for  
success.  
So we will talk more about a margin impact on '09 in January when we give '09 guidance. But suffice it to say at least with respect to say  
the Starz content and the dramatic growth in the library during this calendar year, we had baked those increases into our guidance for  
the current calendar year. And we've remained on plan from a spending and margin perspective.  
   
Reed Hastings Netflix - President and CEO  
And one part of that question was, if record [I] catalog shipments in Q3 sustainable and the answer is partially yes. As our Website gets  
better at matching people with movies, that tends to shift people to catalog.  
And substantially not in that it is seasonal, Q3 is the lightest season for new releases. Q4 and Q1 that we are going into are much heavier  
and this Q3, because of the Olympics, studios really avoided putting out a big new releases during that time period. So it was linked  
leaner in that and that is advantageous to us on catalog.  
   
Barry McCarthy Netflix - CFO and PAO  
And the catalog mix this third quarter was the same as it was in third quarter a year ago.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Andy Hargreaves of Pacific Crest, are you concerned about the emerging conflicts between your service and CE devices and  
retailers who sell DVDs?  
   
Reed Hastings Netflix - President and CEO  
Like retailers who sell DVDs like Best Buy, Wal-Mart -- not particularly. I think they know that the consumer has a lot of options on cable  
and over the Internet. And we are partnering with them to try to figure out how to sell more devices in a kind of a -- a win-win model,

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especially pushing Blu-ray.  
So don't see a lot of conflicts coming on that path.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Ken Smith at [Munder], what is the Bay Area household penetration and the rest of the country household penetration?  
   
Barry McCarthy Netflix - CFO and PAO  
The Bay Area penetration at the end of the third quarter was 18.8% up from 18.5% last quarter. So a 30 basis point improvement. The  
rest of the country finished at 7.4%, up from 7.2% in the second quarter. So for rest of country that was a 20 basis point increase, same as  
it was a year ago Q2 to Q3. And a year ago Q2 to Q3 we saw a 40 basis point increase versus a 30 basis point increase this year.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Youssef Squali of Jefferies, your year end subscriber guidance is now lower than what you gave out a couple of weeks ago. Is that  
an indication of a slower than expected October so far?  
   
Reed Hastings Netflix - President and CEO  
Yes, a little bit.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Lloyd Walmsley at Thomas Weisel Partners, your cost of subscription revenue was down 4% Q over Q, while fulfillment expense  
was up 4%. Was there's something related to the usage added that increased the fulfillment cost on a onetime basis? Or is there  
something structural that will impact fulfillment expense going forward?  
   
Reed Hastings Netflix - President and CEO  
There was no big structural change during the quarter. So if there's a little (inaudible) there, it might be the outage, but there is nothing  
structural going on.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Doug (inaudible) at Barclays capital, if the macroenvironment were to further deteriorate in 2009, would you [save] digital content  
spending versus what you're currently contemplating for the purpose of delivering EPS?  
   
Reed Hastings Netflix - President and CEO  
That would definitely be on the table. It depends on what that climate looks like; what the revenue growth and earnings growth look like.  
But if we are in an extraordinary situation like that, then there are no sacred cows and we would look at each element.  
Keeping subscribers and earnings growing has always been very important to us. You know we have had a great track record on a  
year-over-year basis, keeping that going, and we want to push through this recession with that record intact.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Also from Doug at Barclays, do you still anticipate one more digital device this year?  
   
Reed Hastings Netflix - President and CEO  
Yes.  
   
Deborah Crawford Netflix - VP of Investor Relations  
From Scott Devitt at Stifel Nicolaus, can you speak to the exclusivity of digital distribution agreements, specifically the Roku and Xbox  
distribution deals? Do partners have the ability to offer their distribution to other content providers? Would you ever have interest in  
controlling or owning this distribution?

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Reed Hastings Netflix - President and CEO  
The terms generally are, Netflix is not exclusive so they can put other video services on those platforms. Xbox already has a very  
successful video on demand service under the Xbox Live Marketplace brand. And Roku has announced plans to open up a platform and  
to have their platform have multiple service providers, which will help with their sales and help addressable households for us.  
So we are supportive of that. It's a pretty wide-open heterogeneous world and we are embracing that.  
   
Deborah Crawford Netflix - VP of Investor Relations  
Operator, we would now like to open the call for a few final questions. Just in case anyone has an additional question, clarification or I  
missed your question. Thank you.  
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PRESENTATION  
   
Operator  
Good day, everyone, and welcome to the Netflix fourth quarter 2008 earnings conference. As a reminder, today's call is being recorded.  
For opening remarks and introductions, I would like to turn the conference over to Ms. Deborah Crawford, Vice President of Investor  
Relations. Please go ahead, Ma'am.  
   
Deborah Crawford Netflix - VP-IR  
Thank you and good afternoon. Welcome to Netflix fourth quarter 2008 earnings call. Before turning the call over to Reed Hastings, the  
Company's Co-founder and CEO, I will dispense with the customary cautionary language and comment about the Webcast for this  
earnings call.  
We will 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 28, 2008.  
We released earnings for the fourth quarter at approximately 1:05 PM Pacific time. The earnings release, which includes a reconciliation  
of all non-GAAP financial measures to GAAP, and this conference call are available at the Company's Investor Relations Website at  
www.netflix.com. A rebroadcast of this call will be available at the Netflix Website after 5 PM Pacific time today.  
Finally, as we noted in the press release we issued earlier today, we are going to conduct the question portion of the Q&A via e-mail.  
Please e-mail your questions to me at dcrawford@netflix.com. And now, I'd like to the call over to Reed.  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
Thanks, Deborah, and welcome everyone to the call. Our goal is to grow subscribers and earnings every year, while expanding into  
Internet-delivered video.  
We made great progress against this goal in 2008. Despite the recession, we grew our subscriber base from 8.7 million to 9.4 million  
subscribers in Q4. As you can see from our Q1 guidance, we expect this strong growth to continue in the first quarter.  
Paralleling our strong subscriber growth was strong earnings growth, with EPS at $0.38 for the quarter, up 65% from a year ago; at $1.32  
for the full year, up 36% from 2007. The strength of our business allowed us to increase EPS at these rates while, at the same time,  
substantially increasing our investment levels in Internet-delivered video.  
In hindsight, in Q4, we under-forecast our subscriber growth, primarily because we underestimated the positive impact of the

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introduction of the multifunction CE devices from LG Electronics, Samsung, Microsoft and TiVo that promote Netflix streaming.  
The second smaller factor in our outperformance was better-than-expected responses to our marketing. The precise impact of the  
recession is unclear, but it's very clear that streaming is energizing our growth.  
While our streaming excess is exciting and we will spend some time on that later on this call, we continue to invest in improving our DVD  
by mail experience. There is a lot of top and bottom line growth left in online DVD rental.  
We expect our DVD and Blu-ray shipments to continue to grow in 2009 as they did in 2008, as we improve our service levels and this  
general e-commerce acceptance helps us growth despite flatness in the overall DVD and Blu-ray rental. We think our annual disk  
shipments will continue to grow every year for many years. And even in the highly penetrated San Francisco Bay area, our shipments are  
continuing to grow.  
In terms of Blu-ray specifically, about 700,000 of our subscribers were renting Blu-ray from Netflix at the end of Q4 and adoption is  
growing nicely. If Blu-ray player prices continue to fall as expected, driven by next generation chip designs, then wide adoption becomes  
increasingly likely and with it extended life of disk-based viewing.  
Our growing scale gives us many operational advantages. We are now up to nearly 60 distribution centers across America and can  
provide delivery to over 97% of our subscribers in about one business day.  
This quarter, we will be attempting weekend shipping in parts of the country which will provide even faster service, both for those new  
subscribers who sign up over the weekend and for those subscribers returning movies at the end of the week.  
The payoff of this relentless, operational focus is the competitive advantage of continuing high levels of customer satisfaction. We once  
again came in on top of [4C] results ranking of customer satisfaction for e-commerce, tied this time at number one with Amazon.  
Our success in DVD by mail is driving our earnings growth as well as fueling our Internet delivery. We are working hard to ensure that our  
success in DVD by mail continues.  
Turning to streaming, in Q4, we substantially increased our investment in streaming content. And we plan to substantially increase our  
spending on streaming content in 2009.  
We have a basic plan at $4.99 per month that offers some streaming of some content and we have premium unlimited plans starting at  
$8.99. One of our content investments is to include Stars Play in all of our premium plans. Stars Play includes the major films of Sony  
and Disney.  
Most of our streaming spend -- most of our streaming content spending however is directly with TV networks and studios. We now have  
over 12,000 movie and TV choices up from [2000, two] years ago and we plan to spend as much money as we can with the studios  
licensing as much content as we can. And we are already one of the studio's largest Internet revenue sources.  
Our spending is limited away by what content is available at reasonable prices. And what we can afford in total, given our earnings goals.  
Our existing subscribers are watching instantly in ever greater numbers. And in just the last month, millions of our subscribers got more  
value from their Netflix subscription by streaming.  
The more subscribers watch online from Netflix, the more likely we think they are to remain subscribers and to watch slightly fewer DVDs  
in a month. Since we don't have a control group of random subscribers who are not enable for [instant] watching, we can tell you exactly  
how large these positive effects on churn and disk usage are, but we believe they exist.  
Increased streaming content not only helps us with our current subs, but also helps us with CE partnerships. One of the main reasons LG

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Electronics, Samsung, Microsoft, TIVO, and others want to offer Netflix streaming to their customers is instant access to compelling  
content with a promise of even more content to come.  
This helps them differentiate their products against non-Netflix-ready devices and adds value to the customer. The LG Electronics and  
Samsung Blu-ray players in particular had a very high connect rate during the fourth quarter. That is, a high percentage of purchasers  
are subscribing to Netflix.  
Xbox and TIVO had a lower percentage, but larger total numbers, due to their software update to their substantial install basis. While we  
don't pay or charge anything to have our software included in devices, we do pay our partners to generate new Netflix subscribers.  
In other words, some of our marketing dollars are going to our CE partners to help create demand for new Netflix subscribers. And that is  
included in our subscriber acquisition cost. Nearly all the CE-generated subscribers also rent DVDs from Netflix, which really reinforces  
the importance of the DVD streaming combination subscription. For the long period, the DVD is relevant to consumers.  
If our CE partners can make more money from promoting us than promoting other services because of our broader relevance then we will  
be able to maintain a preferred placement over time. We continue to gain new and deeper partnerships with CE manufacturers. At CES a  
few weeks ago, Samsung and LG announced the expansion of Netflix into a wider range of their Blu-ray models in 2009. And to have the  
Netflix application included directly in some of the LG broadband-connected televisions.  
Similarly, we announced our first partnership with Visio to have the Netflix application included in their televisions. We are in discussions  
with nearly every major CE company and, one by one, we hope to be able to broadly cover the Blu-ray category and the Internet TV  
category over the next few years.  
In terms of having our Netflix application included in additional video game consoles, we currently have an exclusive deal with Microsoft  
Xbox. We have been very busy expanding our CE device partnerships, but we also added support for Apple Computers and improved our  
PC-based player. We see the laptop as a significant long-term viewing platform, not as an intermediate step towards something else,  
and are investing accordingly and continuing to improve our laptop-based player.  
Our first CE partner, Roku, recently announced that their devices -- including the installed base of Netflix players -- would be updated to  
include the Amazon pay-per-view service. We are fully in support of this and let me explain why.  
There are three primary economic models for streaming. Add supported such as Hulu and You Tube, pay-per-view such as Amazon and  
Apple, and subscription such as Netflix. The downside of our CE partners adding the Amazon pay-per-view service is more competition  
for Netflix, but the competition is pretty indirect because most of the pay-per-view business is in big new releases that we don't offer on  
streaming subscription.  
The upside is that Amazon will also be promoting the streaming CE devices, which provides us more households to stream our service to.  
Similarly, CE companies are adding the add supported services to their devices. The combination of all of these models will accelerate  
adoption of video streaming.  
At some point, the ad supported companies or the pay-per-view company may decide to also provide subscription like Netflix. The Netflix  
competitive advantages are that we combine streaming with DVD rental, and that our large subscriber base helps us support more  
content, and that we are significantly subsidized streaming content for the next few years.  
Our intent is to focus exclusively on our subscription model as it is large -- as it is a large enough opportunity for us and we are more  
likely to prevail by focusing on subscription. Consumers who subscribe to Netflix also go to movie theaters, buy DVDs, subscribe to cable,  
use pay-per-view services, watch YouTube and Hulu, and even read DVDs from local stores.  
No firm or model owns an entertainment customer and we think there is room for us to create a large subscriber base while other firms  
also succeed with their model.

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All in all, we are making solid progress in our online video efforts. We are still in investment mode for Internet delivery, but we can see  
how between the CE partner promotion and the possibly reduced disk usage, we should be able to keep increasing our content  
investment while, at the same time, growing earnings in accordance with our desires.  
In terms of competition, the market for entertainment video remains intense. DVR-based television continues to grow. Free ad-supported  
Internet video services are growing. Kiosk-based $1.00 DVD rentals continue to grow. VOD from both cable and the Internet companies is  
growing, and video stores are only shrinking slowly.  
Despite this intense marketplace activity, our consumer proposition is working well. And we continue to significantly expand our  
subscriber base.  
I will close where I started. We had a strong fourth quarter capping off a solid year. We had good growth in our core DVD offering and  
growing momentum in our instant watching. We currently expect to hit 10 million subscribers this quarter, which is a wonderful, hugely  
symbolic milestone of which we are proud.  
And now, I'll turn it over to Barry.  
   
Barry McCarthy Netflix - CFO and PAO  
Good afternoon and thank you for joining today's call. Q4 performance will be the focus of my remarks. I'll also comment on our Q1 and  
full year 2009 guidance and update you on our stock buyback authorization and repurchase activity.  
Sub growth, revenue, SAC, churn, gross margin, net income, EPS, free cash flow. All these metrics were better than we expected in Q4  
especially free cash flow of $51 million, which was more free cash flow than we had produced in all of 2007 -- a new record.  
I will provide more detail on the quarter in a moment, but first I want to acknowledge that our October forecast of slowing growth turned  
out to be wrong. As Reed indicated our CE partnerships and our expanding library of licensed content has a positive impact on our  
growth in Q4.  
We have been heavily investing in Internet delivery for several years. And Q4 was the first time we saw the benefits in terms of  
significantly faster sub growth, lower SAC, more profit, and greater enterprise value.  
So let's look at the drivers of Q4 performance in more detail. Subscriber growth accelerated during the quarter. And we finished 2008 up  
26% on a year-over-year basis. It was our fourth consecutive quarter of 20 plus percent net sub growth -- remarkable, considering we cut  
marketing spending on a year-over-year basis by 8%.  
The acceleration in sub growth was accompanied by near-record low SAC of $26.67. In addition to the multi platform growth I just talked  
about, near-record low SAC was driven by stronger growth across paid acquisition channels and word-of-mouth combined.  
As the quarter unfolded, it became clear from the underlying performance of the business that we could drive faster growth with  
increased marketing spending of $8 million and still meet street expectations for Q4 earnings. This increased spending helped drive the  
performance on netting subscribers and we continue to see strong momentum in our business quarter to date.  
Gross margin improved 140 basis points year-over-year to 35.2%, despite the 2008 postal rate increase and the growing expense of  
licensing Internet-delivered content. With great engineering talent, we continue to improve our Website's ability to merchandise longtail  
content, which was an important contributor to margin expansion.  
The sequential improvement in margins of 100 basis points resulted from the expected seasonal decline in DVD usage in Q4. Two  
additional observations about gross margin.

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One, we are seeing early signs of less DVD usage with some subscribers, who are also watching instantly as compared to subscribers who  
only receive DVDs. Time will tell whether the substitution effect is an attribute of early adopters were a mainstream behavior.  
Over the long term, if this substitution effect becomes a mainstream behavior and other things being equal, Netflix profit margins would  
expand as postage and packaging expense is replaced by streaming expense. This margin expense would be offset somewhat by higher  
content cost, which would accelerate revenue growth for our studio partners, a win-win proposition for us and for them.  
My second observation is that one of the primary determinants of gross margin for the foreseeable future will be the overall level of  
investment spending in online content. The level of spending will be paced by our success with streaming and our determination to  
continue to deliver strong earnings growth.  
As I mentioned in my opening remarks, free cash flow of $51 million was remarkably strong and established a new high watermark for  
the business. The largest sequential growth drivers were a $19 million increase in deferred revenue from the sale of gift subscriptions,  
followed by a working capital increase of $11 million, and higher net income excluding non-cash items such as depreciation and  
amortization expense of $6 million, offset by a $15 million increase in content spending.  
Some of these seasonal factors and timing differences, like the growth in deferred revenues in AP, will reverse themselves in Q1 which  
brings me to the subject of guidance. Our Q1 guidance reflects the strong momentum we see in the business today. The full year  
guidance assumes a continuing difficult economic climate. From our perspective, subscriber growth in the back half of the year is subject  
to greater uncertainty than in prior years, both because of the economic climate and because the increased complexity around Internet  
streaming. You have only to look at our forecasting miss in Q4 to see an example of this.  
So while our full-year forecast of decelerating net sub growth represents our best and possibly somewhat conservative thinking, we  
acknowledge that the full year could be much better than we forecast like it was in Q4 or it could be somewhat worse.  
Given the rapid growth in the popularity of our stream content as more and more Netflix subscribers are able to consume that content on  
their TVs, we expect the popularity of our $8.99 subscription plan to continue to grow and SAC to continue to remain below $30.  
Our guidance assumes a $0.02 postal rate increase in May of this year. In the event postal rate increase by less than we forecast, we  
would likely reinvest some of the savings in growing the business faster. With or without this added investment, we will grow on a  
percentage basis our investment in the Internet delivery of movies and TV content significantly faster than the year-over-year percentage  
growth in revenue.  
Over time, we expect this incremental investment to generate faster subscriber growth and potentially lower churn and lower disk usage,  
as well as more profit and more enterprise value.  
As is customary in Q1, we expect to see a sequential decline in gross margin related to seasonal patterns of disk usage. By way of rebut a  
reminder, disk usage tends to pick up in Q1, down in Q2 and Q3, and Q4 is lower still. Gross margins tend to move inversely with disk  
usage.  
At a high level, I would say our core financial objective for 2009 is to grow net income by at least 12%, even as we significantly increase  
our investment in Internet streaming. And if we began to outperform our net income forecast, our secondary objective is to reinvest some  
of the additional profit in even more spending on Internet streaming and/or subscriber acquisition expense to derive future profit growth.  
And, finally, I would like to provide an update on our stock buyback program. During Q4, we repurchased $10 million or 499,000 shares  
at an average cost of $20. The balance of the unused authorization, about $50 million, expired on December 31st of last year. For the full  
year 2008, we purchased a total of 7.3 million shares, offset by stock option grants and ESP issuance of 1.1 million shares, for a net  
decrease in outstanding shares of 6.2 million.  
Under previous authorizations, we have repurchased a total of 12.1 million shares at a total cost of $300 million, and an average cost of

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$24.85, reducing our year-end fully diluted share count by 17%.  
Today I am pleased to announce the Netflix Board has authorized a new share repurchase program for 2009. Based on the Board's  
authorization, we anticipate a repurchase program of up to $175 million. Future repurchases would be made in accordance with this  
authorization.  
In closing and in summary, Q4 results were better than we expected -- actually much better -- and we continue to see strong momentum  
in the business today. We are excited by the early indications that our investment in the Internet delivery of movie and TV content is  
beginning to bear fruit; and we look forward to talking with you about the performance of the business again next quarter.  
So now it is time to answer your questions and as a reminder we would like you to email your questions to Deb Crawford at dcrawford --  
with a C -- @netflix.com as you did last quarter. Deb will read the questions out loud. Reed and I will do our best to answer them.  
So, Deborah, over to you.  
QUESTIONS AND ANSWERS  
   
Operator  
Once again if you would like to ask a question please email to dcrawford@netflix.com. Ms. Crawford, I will turn the conference back over  
to you with the first question.  
   
Deborah Crawford Netflix - VP-IR  
Thank you. The first question is from Michael Olson at Piper. What can we expect for the trajectory of Watch Instantly content  
acquisition? First part of that question.  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
As Barry said, we are going to increase the spending faster than revenue growth. If you are looking for title count, we are trying not to get  
measured by that because sometimes a single set of big titles makes a bigger difference than 1,000 small titles.  
So there's some correlation with title count and it will continue to rise, but what we want to do is have more and more relative content for  
our subscribers. And we have made good progress on that to date.  
   
Deborah Crawford Netflix - VP-IR  
Second question also from Michael Olson -- the revenue and subscriber guidance in Q1 in 2009 is higher than we anticipated. But EPS  
guidance is essentially in line.  
Can you talk about what expectations are offsetting higher revenue? Is it Watch Instantly or marketing spend?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
Well, difficult for us to respond to changes in our forecast as compared with your expectations since, obviously, we are on slightly  
different pages. I'd remind you that as the business grows faster, we also incur marketing expenses associated with the growth in those  
subscribers and then over the life of those subscribers, we capture value in terms of lifetime profit and enterprise value.  
So it may simply be a timing difference.  
   
Deborah Crawford Netflix - VP-IR  
From Jim Friedland at Cowen. Are the cuts in G&A from the shutdown of Red Envelope and the recent downsizing of Watch Instantly  
customer service now behind the Company?

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Reed Hastings Netflix - President, CEO, and Co-founder  
Red Envelope. Yes. We're not sure what the other --.  
   
Deborah Crawford Netflix - VP-IR  
He said downsizing of Watch Instantly customer service.  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
I think that might be a reference to, we've had in our customer support group, people who had to debug low-level PC issues because our  
software had low-level PC bugs. We did a new release of our PC watching client which is substantially free of those errors.  
And so we were able to release a number of those technical specialists to customer support. So I think that is what that's in reference to.  
Which is, there wasn't work for them to do that was technical in nature.  
   
Deborah Crawford Netflix - VP-IR  
The next question is from Rich Ingrassia at Roth. Do you think you are still pulling the majority of your new subscribers from the pool of  
current or former Blockbuster members? If not, from where then?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
I don't know that we've ever pulled the majority of our subscribers from current or past Blockbuster subscribers. I don't perceive a  
material change in our -- where subscribers come from. A lot of them, they are multiuse customers. They do pay-per-view, they buy, they  
rent, they are involved in media.  
So there's no big shift there that we've perceived about where subscribers come from.  
   
Deborah Crawford Netflix - VP-IR  
Doug Anmuth at Barclays Capital. Can you talk about the reclassification in the cash flows statement, etc., for streaming content?  
   
Barry McCarthy Netflix - CFO and PAO  
Sure. I've gotten several questions about this. With the evolution of our acquisition of streaming content, we determined in consultation  
with our orders that the streaming content should be classified in accordance with FAS 63, which is new; and the portion of the  
streaming content that is expected to be amortized on a straight line basis over the next 12 months is classified in the current content  
library. The acquisition of streaming content is classified as operating activities in the cash flow, different from DVD. But there's no  
impact on the income statement or free cash flow.  
   
Deborah Crawford Netflix - VP-IR  
Srinivas Anantha at Oppenheimer & Co. I know that the streaming service is currently complementary to the normal suspension service.  
But in the future do you plan to launch a dedicated streaming service?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
There's definitely a possibility. There is nothing that prevents us from offering dedicated. Our view on it is, the bulk of the market is  
interested in the big new releases and in the subscription and we're able through the DVD combination to provide that.  
So it is definitely a possibility for the future. But we don't think there's a big market there for dedicated streaming -- or streaming only,  
given the content availability situation, which is roughly 100,000 titles on DVD and about 12,000 on streaming.  
   
Deborah Crawford Netflix - VP-IR  
The next question is from Colin Sebastian at Lazard. Do you have any plans to expand Internet delivery from streaming videos into the  
rental or purchase of digital download?

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Reed Hastings Netflix - President, CEO, and Co-founder  
That's not an area as I went through my comments about pay-per-view and when whether pay-per-view or streaming or download, it's  
essentially the same thing. That is really about our brand. Our brand is really about a monthly entertainment subscription and that's  
what we're focused on. So we don't have any plans to be involved in those markets where Amazon, Apple, Blockbuster, a few others play.  
   
Deborah Crawford Netflix - VP-IR  
Matthew Hart at VanKampen. Would you ever look to acquire Blockbuster's mail business?  
   
Barry McCarthy Netflix - CFO and PAO  
Never say never, but I think those days were big two, three years ago and most people were focused on now is expanding in the  
streaming direction.  
   
Deborah Crawford Netflix - VP-IR  
Second question also from Matthew Hart. What are some of the key technological hurdles preventing broader adoption of streaming?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
I don't know if they are really broad technological hurdles but the broad hurdles are just having people get used to it. First stage is having  
people watch Internet video on their PC -- their laptop, from You Tube, from Hulu, from CNN, from Netflix. Second stage is through  
Internet-baked devices -- game consoles, Blu-ray, TV.  
And then what you'll see is more and more content providers follow ABC, CBS, etc., and provide the streaming on the Web. So the  
ecosystem is building very nicely; Internet video is on a significant rise and that's bringing in advertisers, subscription, pay-per-view and  
all the content providers.  
So I think we'll see very significant growth in online video over the next five years, and we intend to participate in that.  
   
Deborah Crawford Netflix - VP-IR  
From Daniel Ernst at Hudson Square. While I realize it is a small base today, if you look at the base of streaming customers using one of  
the hardware solutions -- Roku, LG, Samsung, Xbox, TIVO -- what percentage of those subscribers are new to Netflix? In other words, can  
you give a sense of the subscriber contribution from those devices?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
I'm going to hold off on providing any detail on that for competitive reasons.  
   
Deborah Crawford Netflix - VP-IR  
Second question from Daniel Ernst. Despite an increase in subscribers and some new releases like Wall-E and Dark Knight, as well as a  
larger base of Blu-ray available films, your DVD library acquisition spend was down both sequentially and year over year. Can you discuss  
content acquisition spend trends?  
   
Barry McCarthy Netflix - CFO and PAO  
Yes, the thing that's confusing there is the difference between rev share and purchase. So you are looking at the purchase (inaudible) the  
balance sheet.  
And that only tells a percentage of the picture and then, some years depending on what rev share deals we have and how hot the studios  
are that we have the rev share deals with, you'll see that acquisition line move around. So it's not a very useful indicator for you.  
We are continuing to invest and provide complete DVD availability and we have every Blu-ray that's out, too, from the major studios. We  
are very committed to that business and it's on par, I would say, with the last couple of years in terms of where the trends have been.

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Deborah Crawford Netflix - VP-IR  
Tony Wible. Janney Montgomery Scott. Are you seeing or do you expect to see any benefit from reduced ad rates for online and/or  
television?  
(Technical Difficulties)  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
Helps the rest of our marketing work and similarly the more that we spend on marketing, it reinforces all those things with our CE  
partners and gets people who want Netflix service then, to buy those devices. So they both reinforce each other in very positive ways.  
   
Deborah Crawford Netflix - VP-IR  
Michael Olson, Piper Jaffray. I have a hard time thinking of a reason why a CE partner would not want you incorporate Watch instantly.  
Can you talk about any reasons why any potential CE partners have pushed back on Watch Instantly integration?  
Also how many additional CE partners can we expect in the next couple of quarters?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
That's a good insight that there is really no reason not to include the Netflix offering. So it has purely been technology which has, some  
chip platforms are more able to handle the streaming of DRM and some take a little longer in the porting activity.  
Some companies perceive it as a high priority to get Netflix in and they will allocate the team early. Other companies haven't yet seen it  
as a high priority. But in all cases, it is not a negative. It is purely around the amount of work that it takes to get in; and the good news is  
we are getting better and better as we do more and more of these platforms of making it easier to put in.  
So I think you can expect a broader range of partners over the year. But again, you don't quite want to think about it as -- or strictly not  
think about it as a number of partners. You want to think of it as kind of a percentage of devices that are sold.  
That is, a few big partners make a bigger difference than a whole lot of smaller ones. So I think our efforts are focused in the right way.  
   
Deborah Crawford Netflix - VP-IR  
Heath Terry at Friedman Billings Ramsey. Does the success of your streaming service renew your interest in expanding internationally? Is  
there an important first mover advantage that you would consider in evaluating that decision?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
Only slightly does it renew the interest. You know we would be on the international doing streaming only there and I don't know if there is  
enough content and a large enough ecosystem to do that. In terms of first mover damage, I'm sure there are. We would love to be the  
first mover in those categories. I'm not 100% sure we will be.  
But for now, we are focused on growing in this very large opportunity in the US and adding, spending more on content and continuing to  
grow earnings and subscribers in the US.  
   
Deborah Crawford Netflix - VP-IR  
Derek Brown at Cantor Fitzgerald. You have mentioned in the past that we should measure, at least in part, your success in the digital  
realm by the number of Netflix-enabled devices in the market by year-end 2009. Could you provide us with the aggregate number of  
Netflix-enabled devices at year-end 2008 and a target for 2009?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
We haven't released specific numbers on how many devices. I think what you've seen in our investments is that we -- our strategy is  
working. That is, we are getting in devices and it is manifesting itself positively in the P&L and the more that it manifests itself positively  
in the P&L, we will be able to ask you to judge us purely by the P&L which is easier for everyone than the indirect of how many partners.

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Deborah Crawford Netflix - VP-IR  
Operator, that's about it. We would now like to open the call for a few final questions. Just in case anyone has an additional question,  
clarification or I missed your question. Thank you.  
   
Operator  
(Operator Instructions). Jim Friedland. Cowen and Company.  
   
Jim Friedland Cowen and Company - Analyst  
Just a few housekeeping questions. One, San Francisco Bay Area, penetration in Q4; two is buyback -- is the buyback included in the  
guidance? And three, which would you be using for an effective tax rate in '09? Thanks.  
   
Barry McCarthy Netflix - CFO and PAO  
Inverse order, 41%; no comment; and 19.4%, Bay Area penetration, 8.1% penetration; rest of country versus 18.8% in Q3 and 7.4,  
[respectably].  
   
Jim Friedland Cowen and Company - Analyst  
Okay, great. Thanks.  
   
Operator  
Youssef Squali. Jefferies & Company.  
   
Youssef Squali Jefferies & Company - Analyst  
Thank you very much. Barry, just a quick clarification. I think you said to -- your answer to a question that was those before that you have  
not seen any benefit from a lower ad rate in Q4.  
I'm just trying to reconcile that. Anything or everything that we're hearing from ad players out there, online ad players is that at least on  
the CP inside and, particularly, on nonpremium inventory, where you guys seem to spend a lot of money, we've seen double-digit  
declines year on year.  
And, given the fact that you are one of the top 20 online advertisers out there, how can you not see a benefit?  
   
Barry McCarthy Netflix - CFO and PAO  
You know, I put the question to our Chief Marketing Officer in almost exactly the same tone. And she reminded me that we already buy at  
low rates in mostly in the remnant market. So what must be happening is that the trickle down effect hasn't yet hit the remnant space  
which is already incredibly discounted.  
   
Youssef Squali Jefferies & Company - Analyst  
Okay to. Thanks.  
   
Operator  
Mark Mahaney with Citi.  
   
Mark Mahaney Citi - Analyst  
Just a quick question on the free trial subs. I know it is a small number, it did seem to tick up a little bit outside of historical norms. Any  
read into that? Do you view that as significant at all?  
   
Barry McCarthy Netflix - CFO and PAO  
That would be the strong momentum through the end of the quarter. The seasonal growth is very back-end loaded in Q4 and tends to be  
very front-end loaded at least historically in Q1. So if you are carrying faster growth into the end of the quarter than you have historically,  
you'd see a higher proportion of free trials.

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Mark Mahaney Citi - Analyst  
Thank you Barry.  
   
Operator  
Doug Anmuth. Barclays.  
   
Doug Anmuth Barclays Capital - Analyst  
Couple of questions. First one is just given the overall decline in DVD sales which we saw last year, is there any change to your overall,  
long-term view that your DVD by mail business peaks between 2013 and 2018? And then, secondly, you commented on the digital spend  
as being greater than the revenue growth, most likely in 2009.  
How would you characterize the increase in digital spend '09 over '08 versus '08 over '07? Thanks.  
   
Barry McCarthy Netflix - CFO and PAO  
We've done a good job of not commenting actually on how much we've been spending and people tell me you've done a pretty good job  
of estimating how much we spent. So we grew it a lot last year and we are going to grow it very fast in the upcoming year.  
As we said in -- during our prepared remarks, as much as the P&L will afford us the opportunity to grow it constrained by our target  
growth in EPS in at least 12% and paced by the success we are seeing in the marketplace.  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
And then, you asked about DVD length. Nothing has changed our view that our shipments and rentals will continue to grow and peak  
some time in 2013 to 2018 as best we can tell.  
   
Doug Anmuth Barclays Capital - Analyst  
If I could just follow up with one more. Barry, do you think that you are being equally conservative in your outlook for '09 as you have  
been in January of other years? Or is there it reasonable to think you are being even a little bit more conservative just given the overall  
macro environment?  
   
Barry McCarthy Netflix - CFO and PAO  
I think we clearly are uncertain about what the second half of the year will bring. I would say. And on balance I think it would perhaps  
have tipped the scale slightly more towards conservatism than optimism because the cost of missing is enormous as compared with the  
upside of [beating].  
And as the year progresses, we will have greater visibility into how it unfolds. I would like to remind everyone that most of the sub growth  
historically has come in Q2 and Q4, and with very little sub growth in Q2 and a slight acceleration in Q3. So we may not have a whole lot  
of visibility until late in about the second half of the year until late in the third quarter.  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
Of course, Barry meant they are Q1 and Q4 are the top growth. You said Q2 (multiple speakers).  
   
Barry McCarthy Netflix - CFO and PAO  
Excuse me. Yes. Q1 and Q4 with not much in Q2 and a slight acceleration in Q3.  
   
Operator  
Heath Terry, FBR Capital Market.  
   
Heath Terry FBR Capital Market - Analyst  
You mentioned that as you start to see a substitution effect there should be a net impact from the decline in packaging and shipping  
costs. Can you give us an idea if there is any impact one way or the other on the content front?

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I guess, put more simply, is the revenue share agreement that you have for online different in any meaningful way from the cost of  
serving disks or the revenue share agreements that you have for your DVD business?  
   
Barry McCarthy Netflix - CFO and PAO  
Your question presumes that content is purchased mostly like the -- rights are acquired mostly on a rev share basis in [ED], and there is a  
combination of fixed and variable just like there is in DVD.  
And I would say that the license rights, the variable portion of the license rights, simply because of the nature of the rights that we are  
acquiring are uniquely different than they are in DVD.  
   
Heath Terry FBR Capital Market - Analyst  
Okay. Thanks.  
   
Operator  
Charles Wolf. Needham & Company.  
   
Charles Wolf Needham & Company - Analyst  
Do you think your business has actually been helped by the recession in the sense that people are not going to theatres as much and  
instead substituting Netflix for that experience?  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
There is no way for us to tell. We are very thankful that would done so well, but whether that is because of the recession or despite it,  
there's no strong evidence to either side.  
   
Charles Wolf Needham & Company - Analyst  
Okay. Thank you.  
   
Barry McCarthy Netflix - CFO and PAO  
I think your answer ran to grow subscriber additions which is the context in which Reed answered it. I think we probably share the view  
that in terms of the turn rate that we have seen it, we are seeing an uptick, a slight headwind related to the recession. So holding all  
other things constant, in the absence of a recession we would expect to see a lower churn rate and faster net sub growth.  
   
Charles Wolf Needham & Company - Analyst  
Okay. Thanks Barry.  
   
Operator  
Tony Wible. Janney Montgomery.  
   
Tony Wible Janney Montgomery Scott - Analyst  
Barry, a while ago you talked about this vintage churn concept and I was hoping you could just updates and let us know how that base  
pool of customers is churning, relatively speaking. And should we still anticipate that they grow to be a larger portion of the sub base for  
the overall churn to kind of trend down?  
   
Barry McCarthy Netflix - CFO and PAO  
I think you are referring to the base of subscribers we spoke about at the analyst day that has been with us for at least 12 months. And I  
think they were at the time of the analyst day roughly 56% of the pay. And a larger percentage (inaudible) -- I don't know what it is. And I  
confess I haven't looked at the turn rate for the subscribers who have been with us 12 plus months, but I don't have any reason to think  
that it has changed in a significant way then.  
It's been very stable for many years. And I imagine it is now as well.

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Tony Wible Janney Montgomery Scott - Analyst  
Okay. Any update on the number of turns that you are seeing on each individual disk or any change in the breakage rates that you've  
seen in the most recent quarter or quarters?  
   
Barry McCarthy Netflix - CFO and PAO  
No. I mentioned that seasonally we saw disk usage decline. I've seen some sellside speculation that with cocooning, usage rates would  
go up. I don't think there is any evidence that that is happening. So the quarter came in about as we expected. Did that answer your  
question?  
   
Tony Wible Janney Montgomery Scott - Analyst  
And on the breakage side, are you seeing -- I guess that's what I was more looking at. Are you seeing any envelopes missing or just how  
long the disks are lasting?  
   
Barry McCarthy Netflix - CFO and PAO  
No real change. I mean, we make a tiny bit of progress most quarters for the prior quarter. A lot of hard work, but there's no material --  
nothing going on.  
   
Tony Wible Janney Montgomery Scott - Analyst  
And Blu-ray versus standard -- I know a way back you were a little bit -- we didn't know how well Blu-ray's durability would hold up. It's  
been comparable to DVD?  
   
Barry McCarthy Netflix - CFO and PAO  
It is much stronger than DVD when -- relative to its format introduction. So when DVD came out, we had a tough situation. And it took us  
a couple of years to get ahead of. We are much smarter now so we are farther down that curve than we were in DVD at this point in the  
life.  
   
Tony Wible Janney Montgomery Scott - Analyst  
Great. Thank you.  
   
Operator  
Andy Hargreaves, Pacific Crest Securities.  
   
Andy Hargreaves Pacific Crest Securities - Analyst  
Does the expectation for online content acquisition costs to go up quite a bit and (inaudible) any expectations for loosening rights on  
premium content?  
   
Barry McCarthy Netflix - CFO and PAO  
No. We are not expecting any change in studio windowing or anything dramatic in that way.  
   
Andy Hargreaves Pacific Crest Securities - Analyst  
So it's a volume issue, not price?  
   
Barry McCarthy Netflix - CFO and PAO  
Yes. I mean, there is a lot of content out there from TV networks and some content from studios and it's just out. You know we are -- so  
there's plenty to buy as we give our buying group money. So it is really just how much can we afford to invest, given our desire to continue  
to grow total subscriber base, i.e., invest in marketing and grow our earnings.  
   
Andy Hargreaves Pacific Crest Securities - Analyst  
And am I hearing you right? That, basically, the margin compression that's embedded into guidance is almost exclusively more content  
acquisition?

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Barry McCarthy Netflix - CFO and PAO  
Well, there's a little bit of postal rate, but, yes, that would be other one.  
   
Andy Hargreaves Pacific Crest Securities - Analyst  
Thank you.  
   
Operator  
That does conclude today's question and answer session. At this time I would like to turn the conference over to Mr. Reed Hastings for  
any additional or closing comments.  
   
Reed Hastings Netflix - President, CEO, and Co-founder  
Thank you, everyone, for joining us this afternoon. To recap and close, the business performed very strongly in Q4 and it looks great  
quarter to date. We are really beginning to see the payoff from our investment in Internet-delivered video. And I look forward to updating  
you on our continued progress 90 days from now. Thank you very much.  
   
Operator  
Again, that does conclude today's conference. We thank you all for joining us.  
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