Good day, everyone, and welcome to the Netflix First Quarter 2012 Earnings Q&A Session. Today's call is being recorded.

At this time for opening remarks and introductions, I would like to turn the call over to Ellie Mertz, Vice President of Finance and Investor Relations. Please go ahead.

Ellie Mertz

Thank you, and good afternoon. Welcome to the Netflix First Quarter 2012 Earnings Q&A Session. I'm joined here by Reed Hastings, CEO; and David Wells, CFO. We announced our financial results for the first quarter at approximately 1 p.m. Pacific Time today. The shareholder letter and the Q1 financial results and the webcast of this Q&A session are all available at the company's Investor Relations website at ir.netflix.com.

As is our standard practice, we will begin the call with questions we received via email. Please email your questions to ir@netflix.com. After email Q&A, we will also open up the phone lines in queue for additional questions not covered by the email Q&A or letter. The dial-in number is within our investor letter, but let me repeat it now. Please call (760) 666-3613 if you would like to get into the queue.

We may make forward-looking statements during this call regarding the company's future performance. Actual results may differ materially from these statements due to risks and uncertainties related to the business. A detailed discussion of such risks and uncertainties is contained in our filings with the Securities and Exchange Commission, including our annual report on Form 10-K filed with the commission on February 10, 2012. A rebroadcast of this Q&A session will be available at the Netflix website after 6 p.m. Pacific Time today.

Now let's move directly to questions.

Question-and-Answer Session

Ellie Mertz

[Operator Instructions] For the first topic we'll take questions on is domestic streaming. First question. Why are you so confident that gross add trends result from seasonality and not slowing growth? How can you be confident in 7 million net additions for the year?

Reed Hastings

Well, we had a fantastic Q1, adding nearly 3 million members to our global subscriber base. We had strong results in all of our territories, including the U.S. Our gross adds are consistent with our historic patterns. Our churn is consistent with our historic patterns, and we're feeling very good about the year. If you look at adding 7 million net adds, which is our target for the year, and you compare that to 2010 where we also added 7 million net adds, in 2010, that was 7 million on top of 12 million starting members. This year, that 7 million on top of 22 million starting members. If the mathematical effect, if that's true, with steady churn, that in adding 7 million on top of 12 million versus 7 million on top of 22 million, that there will be a significantly increased seasonality of net additions. So the business is performing exactly as we had hoped. We are continuing to execute on all of the key dimensions. But the artifact of having 7 million net adds on 22 million increases the seasonality relative to 2010, and we tried to demonstrate that or illustrate that in our appendix showing this phenomenon. So everything is consistent with what we've been hoping for, and so that's why we feel good about the year, continuing like this. It's probably secondarily all of the macro factors are very good, which is broadband is continuing. We're getting better and better content. Viewing is at record levels, and consumers want click and watch on-demand Netflix Internet television.

Ellie Mertz

A follow-up question to that. What will be the earliest indicators that you can or can't achieve that 7 million net U.S. streaming subs goal for 2012?

David Wells

I think the earliest indicators will be our net additions in Q2 going into Q3. So when looking at as we continue to see the same net addition rate both with the strength of the new members that we're bringing on to the space and the user engagement that we see both with new members and existing members, if those trends continue forward, we would expect to be continually confident in our ability to add 7 million members.

Ellie Mertz

Can you discuss the rate within the quarter of subscriber additions or their seasonality within the quarter?

Reed Hastings

Those seasonality, if you want, there's variation month-to-month, week-to-week that follows pretty typical patterns. And all of those patterns have stayed consistent -- are going consistently. And again, the main consternation that we picked up is while the growth adds are steady and following the traditional seasonal patterns, why is the net adds different? Why are the net adds diverging? And the answer is just a factor of, I'll slightly repeat myself of the math of, it's on top of 22 million instead of on top of 12 million that we tried to demonstrate in the appendix the way that works. Do you want to add anything in?

David Wells

No.

Ellie Mertz

We got another question on that. Churn spiked after the price increase but remains above historic levels. Will churn come down or is streaming-only structurally higher churn? Please explain your rationale.

David Wells

Just on the prior question, too, I think the prior question asks narrowly what the seasonality in Q1. It follows the prior seasonal pattern, so just to make sure we answer that question. And then could you ask that question one more time.

Ellie Mertz

Sure. Churn spiked after the price increase but remains above historic levels. Will your churn come down or is streaming-only structurally higher churn? Please explain.

David Wells

What we said before is streaming-only does have a slightly higher churn rate than our DVD service did and sort of part of our legacy. It's easier to come in and out of that service than the DVD having the DVDs at home and having to mail them. We would anticipate that, that need continues forward. But we do retain subscribers that have been with us longer at higher rates than subscribers that join our service. So as the base ages, the retention rate -- the overall retention rate improves. Therefore, as the age basis, that retention rate will improve just like it did with our DVD service.

Ellie Mertz

How should we think about 2Q seasonality this year relative to last year when you added 1.8 million subscribers on a similar overall base?

Reed Hastings

In last year 2011, we were on track for 11 million or 12 million arguably net adds on a starting base of 19 million. And so that roughly parallels the 7 million net adds on 12 million from 2010. And it's the ratio of net adds to a starting base that's different this year, and that's what creates the variation in net additions. So this year, we're at 7 million -- targeting 7 million net additions on 22 million, and that's what's different from last year. So again, it comes back to the essentially these unintuitive math effects if you got consistent churn across the year that the net adds seasonality increases. Again, the easiest way to see that is in the 3 tables at the very end of the letter where we've abstracted some examples to try to get comfortable with that phenomena. So we feel very much that we're on track for the 7 million net additions for the year.

Ellie Mertz

What's sort of the upside in contribution margins for the U.S. streaming business? Was there a timing issue associated with content cost?

David Wells

We talked about in the letter streaming content costs were lower, some customer service costs were lower and the delivery costs were lower. On the content side, we actually were pretty close to what we expected in terms of expense. But because it's such a large number, if you're slightly under that, it can be meaningful in terms of contribution margin. And most of what I saw was several small deals got pushed into Q2 or didn't close as of the end of the quarter.

Ellie Mertz

Is the domestic streaming outlook tied at all to H.R. 2471? Meaning, do you assume passage of this amendment at some point?

David Wells

H.R. 2471 is our bill to amend and improve and modernize the VPPA, and no, there's no assumption built into the numbers of that passing.

Ellie Mertz

At current churn levels, over 20 million people will turn off the U.S. streaming service at some point. Are you concerned that the large number of people that are trying Netflix and unsubscribing will ultimately prevent you from reaching your target of 60 million to 90 million U.S. subscribers? So alternatively, how much is churn if people are turning the service off and on repeatedly?

Reed Hastings

Lots of churn is people turning to service on and off. In other words, you join for 3 months, then you're not using it or you run out of money, so it's off for 3 months, then it's back on. Because we only offer a free trial to new members, subscribers particularly who are economically sensitive, price sensitive, had an incentive to them to start Netflix again under a different email address than they've had before. So there's no real clean counting of that dimension. What we feel great about is the very strong growth adds, the churn that's in line with our historic trends. So we're feeling quite good about the numbers.

Ellie Mertz

Question on domestic cost. You priced your Q4 2012 domestic streaming contribution profit assumption to 17%. What's the biggest driver of that? Is it streaming content cost coming in lower than anticipated? Do you expect continued contribution margin expansion in 2013?

David Wells

The biggest driver are deals that we thought would close slightly earlier than they did and that has a carryforward effect from Q1 to Q2. So I'd say that's the largest driver of that contribution margin outperformance.

Reed Hastings

And in terms of 2013, we haven't given any guidance. We would like to see 100 basis points per quarter go on for as long as we can. But we're going to have to feel our way through that year-by-year.

Ellie Mertz

In January 2012, Netflix indicated that over 2 billion hours of content have been streamed globally in Q4. You alluded to continued growth in Q1 2012. Can you provide any more color as to the increase in streaming hours per sub per quarter sequentially?

Reed Hastings

There's a reasonable amount of seasonality in viewing times in the Northern climates due to long nights, so we really compare this on a year-over-year basis as opposed to sequentially. But I can tell you that Q1 was all-time record for us in total viewing and in viewing per members. But in Q2 because of the seasonal, again, we'll compare that on a year-over-year basis.

Ellie Mertz

And then 2 question on profit outlook. Do you still anticipate net income losses for all of 2012, i.e., will losses in the fourth quarter international eat up the surprisingly high profit delivery in Q2 2012 and presumably through 3Q 2012? Do you expect to lurk around breakeven in 2013 as you would reinvest domestic profits into international expansions?

David Wells

So I think we addressed this in the letter, but in terms of Q2 profit expectation, if you take the midpoint of guidance, there's a modest net income profit. What we said is we would continue to launch international markets and stay about roughly breakeven. So with the Q4 launch, we would probably be facing a small loss rather than breakeven and then work our way back to breakeven.

Ellie Mertz

Let's take the questions on content. Do you expect to slow the growth in U.S. streaming content spend? And do you believe there's a certain terminal amount of content that is needed to sustain any number of subscribers, whether it be 25 million or 40 million subscribers? Said another way, do you think Netflix has to spend considerably more on content to grow from 25 million to 40 million subscribers?

Reed Hastings

We're growing content spend and content offering very aggressively going forward. And revenue is growing faster than that, so that's where we get the widening margin. But we have fractured -- a smallest fraction of the total amount of content that we would like to eventually have. So we will continue to grow the investment in content quite aggressively, slightly less than the rate of revenue growth.

Ellie Mertz

You secured the DreamWorks Animation output deal well before the 2013 start date. Are there other studio output contracts that are coming up for renewal such as Fox, Universal, Disney and Sony? Are these all beginning 2014 or '15? Will they similarly be bid out well before the start date? Do existing pay cable channels have right of first refusal?

Reed Hastings

It's highly variable by deal 2014 to 2015 when most of them come up. And as far as I know, no one else has right of first refusal.

Ellie Mertz

What is the current status of Epix content as it relates to exclusivity and what you intend to do going forward?

Reed Hastings

Epix is on cable, and it's on EpixHD, which is a TV Everywhere extension of Epix and it's on Netflix. That's all that it's on right now. And then as we go forth with Epix, we're in a broad range of discussions with how to operate most effectively for both of us.

Ellie Mertz

Here's a handful of questions about originals. How significant to overall views are exclusive or original content?

Reed Hastings

Well, the exclusive and original are 2 different things, so Breaking Bad's exclusive but not original as an example. Originals are just beginning, so all we've got up is Lilyhammer. So it's not yet hugely significant. But as we add in the next couple originals coming later this year, that will builds to a nice percentage of our total viewing.

David Wells

And I would say we look at the performance of those pieces of content like any other pieces of content in terms of cost per hours viewed and its efficiency. So across that class of content, we would expect to compare it against other like content.

Reed Hastings

We think we can produce contents at no greater cost than that per hour of viewing essentially than it would cost to get license, and then we have the advantages of the brand halo as well as the defensive hedge if we need it over time.

Ellie Mertz

Can you discuss how successful Lilyhammer was? Maybe helping to place it in perspective for its views versus other shows?

Reed Hastings

It was quite successful for the amount that we invested in and the amount of the cost. And it parallels some of the other premium exclusive content which we've got, like the Breaking Bad, in terms of its ratio of cost to viewing. So we feel really good about that of our first shot out. And as House of Cards and the other originals that we have come forth next year, we'll be very excited about those also.

Ellie Mertz

Is the cost associated with originals will ramp in 2013? Any way we can quantify the impact of that?

Reed Hastings

It's really just part of content cost, that is we'll spend in the neighborhood of single percentages of our total spending content spending for next year on a P&L basis with the originals. So for us, it's just another source of content.

David Wells

And I think what we said in the letter was that free cash flow, the cash will actually ramp as originals ramp into 2013. So the costs are already baked into our assumptions around content expenses. It's the cash that we'll ramp noticeably in the back half of the year.

Ellie Mertz

Here are some more questions. Netflix appears increasingly focused on exclusivity, especially compared to 12 to 18 months ago. Should we expect the vast majority of your content to be exclusive by year end 2013? In turn, is it reasonable that content spending will continue to move notably higher next year, as well as due to healthy sub growth?

Reed Hastings

As we move up in the content buying economic strata, you start off with the kind of low-end, nonexclusive content. And then as you want to get shows like Mad Men, you have to outcompete with other cable networks to get those shows in syndication and those are exclusive licenses. And so we started doing more and more of those. As we want to do direct deals with movie studios, like DreamWorks Automation, that the other bidders will not take that content if we also have it. So those are de facto exclusive. So this exclusive trend has been going on towards more and more exclusive and will continue as we climb the economic strata and have better and better content. It's a natural outcome of us being a network like other cable networks, all of which are exclusive against each other. I don't think we'll have all of our content exclusive really at any point in time because we'll continue to also have a broad range of nonexclusive content. But certainly, there'll be more and more that is exclusive.

Ellie Mertz

Can Netflix survive as a middleman? I define middleman as an intermediary between content owner and end user. Is the company's largely middleman status the reason for its apparent evolution to, at least in part, original programmer? How long do you think it will take to become a credible peer to HBO, which has had smash hit originals such as The Sopranos and Sex in the City?

Reed Hastings

Well, there are lots of middleman that are hugely successful in many different industries. And sometimes, they verticalize the production and they have store brands for various items, and it doesn't mean that they're middleman or retail status is weakened. They do that to strengthen themselves. And if you think about HBO, initially it was on almost all licensed content and then they grew in as they gain scale to also doing produced content. But still, a majority of HBO's budget is on content produced by others, by the major studios. So yes, we feel very comfortable about being an aggregator that packages together an incredible set of content to provide a great value for consumers and that's a great position to be in.

Ellie Mertz

What is the balance of streaming content as of 3/31/2012, that are not currently reflected on the balance sheet?

David Wells

I think that's referring to the content and contractual obligations. And at the end of Q1, that was $3.7 billion, which compares to $3.9 billion as of the end of 2011 and $1.8 billion a year ago. So it's down slightly from the end of the year as we moved content from that table on to the balance sheet, and that it became a window essentially in that asset recognition criteria.

Ellie Mertz

Now just as a follow-up to that. If you include what's in that note to the financials, if you add up the accounts table, you'd see that our total minimum commitment for streaming content is flat quarter-over-quarter.

The biggest complaint I hear is that Netflix has a weak library of streaming content. While keeping pricing low is a strategy that seems to be working well, it prohibits this very common complaint from being addressed. Has Netflix proposed the idea of a tiered subscription plan for online access? Is silver, gold and platinum plan, which would open up a increasingly larger and more popular library, could both address this issue and increase profitability? Has this ever been considered?

Reed Hastings

No. We're very focused on keeping our proposition extremely simple. We think that, that is the right strategy when we're in this rapid phase of growth of the market, to have a single, paid dollar unlimited product in the marketplace. Eventually, in the next curve model, in the tail phase when the market matures, then you'll look to segment in various ways. But knock on wood, we're a long way from that, and we'll continue to focus for the foreseeable future on a clean, simple proposition.

Ellie Mertz

Cable ratings from many networks have declined this year. Do you believe networks are attributing this to Internet TV? And could it impact pricing on renegotiating TV content deals?

Reed Hastings

No, I'm not sure why cable network ratings are -- some are up and some are down. I think it's mostly due with the individual programming. If you've got incredible programming, there's several examples where the ratings are up. And in terms of how it affects us, we've got the ability to pay because we've got a larger subscriber base than anybody else. So to the degree that the prices are higher, we're still able to deliver on the consumer proposition.

Ellie Mertz

Well, just some questions about competition. Are you still thinking Amazon will do a stand-alone streaming product outside of Prime?

Reed Hastings

Our understanding is that it will still happen, yes. In terms of particular time frame, we're not sure on what that might be.

Ellie Mertz

You talked a lot about net neutrality. What do you see is the most realistic and/or likely path towards enforcement of net neutrality?

Reed Hastings

Well, I'm not sure at this point. I think we're broadly socializing the idea of what's neutral and what's not, and we documented one clear example where we think this is not at all neutral. And we're engaged in a public discussion, essentially, of the issues. So we'll see how that plays out.

Ellie Mertz

Three related questions. Why are you so concerned about Comcast and bandwidth caps? If 1 hour of streaming time takes up a mere gigabit of bandwidth, and the Comcast monthly bandwidth cap is 250 gigabit, implying 8.3 hours per day of viewing time. Why the concern, especially if you believe that the Netflix streaming product is vastly superior to Xfinity?

Reed Hastings

Well, I think the concern we have is with the principles of net neutrality. Obviously, with a high enough cap, it kind of doesn't matter. But if something is accepted with one cap, we may find the next year that the cap is much lower. And so I think we have to really start to figure out the principles and advocate for those upon which we're all operating. I would agree. It's not a near-term issue with the 250 gigabyte cap. But the core principle is important anyway, which is the cap should be applied equally or not at all.

Ellie Mertz

I was wondering what Netflix will do to increase and hold existing subscriber base in the U.S. and elsewhere with so many other companies entering the streaming video business.

Reed Hastings

Well, I think what's happening is everyone's realizing that consumers want click and watch on-demand, and so there is a lot of announcements of everything from start ups to large companies. And we've been focused on this market for a very long time and have some substantial advantages because of that in terms of the breadth of our integration in the various devices, in terms of our on the remote control buttons that we have on Smart TVs, in terms of our integration into all of the game consoles. We have big advantages in terms of the development of our website in the core service, the algorithms and the personalization. We have incredible content. It's not as broad as we'll eventually have, but it's much broader than any competitor. So often what happens is when there's a lot of attention on the market, there are new competitors, but the leader gets the majority of the benefit of that and it's our job to continue to deliver for consumers so that we're chosen more often than anybody else.

Ellie Mertz

Let's turn to questions about international. What have you learned from existing market launches that you apply to as thought process of selecting your next international market that you've indicated will launch in Q4 this year?

Reed Hastings

Well, we've been really happy with the U.K. and Ireland, just great results there. We've got great results in Canada. And in Latin America, we'll get there eventually, but it's going to be long going harder than we initially thought. So we'll tend to be more towards developed markets that are more like Canada, U.K. and Ireland than strong emerging markets like Latin America.

Ellie Mertz

Your international expense guidance on January's Q4 call forecast $5 million for subtitling. Yet your release today, only months later, says your incentive capitalized such expenses. Why change from passive media expensing to a more aggressive income presentation?

David Wells

The costs were immaterial in the past. They rose in Q1 as we talked about in the letter, getting more towards 100% of our offering in Latin America subtitles. So we faced increased cost in Q1. And the prospect as we launch additional non-English markets is that these costs will be material. So from an accounting standpoint, when your low, it don't matter. You don't have a policy. When they become material and in bulk, they are material and they stay material, there's more argument that they'll be capitalized. And we look at this and we needed to create a policy in Q1, and we didn't have that accounted in our forecast.

Ellie Mertz

Question on Latin America. Latin America, we fully understand the limitations of infrastructure, credit cards and broadband hindering uptick. What I would like to know is what about the progress there that gives you confidence that it will succeed, albeit at the slower pace than you had initially expected as opposed to not work at all?

Reed Hastings

In Latin America, we're seeing a very nice revenue growth. It's just not as fast as we anticipated in terms of catching up to the content. So if there was a situation where we didn't have revenue growth, that would worry us, but that's not the situation that we have. We're seeing very nice revenue growth, and we're continuing to improve whether it's payment, whether it's the streaming delivery, all the other systems. And second, there's no competitor that's ahead of us. If we were would then be beaten in some nation by some other competitor, that would have us maybe rethink how long would it take us to get to profitability. But again, that hasn't happened. So for now, we've got a rapidly growing business. It's still running at a loss, and it's going to take longer, we think, than 2 years to get there. But the vectors are all in the right direction.

Ellie Mertz

Could the iTunes integration be extended beyond Apple TV to iPhones and iPads, too, in order to ameliorate the e-commerce payment problems in Latin America and elsewhere?

Reed Hastings

There's a number of integrations we could do. One would be in the iTunes aspect, others would be with ISPs, others would be with cable companies. So we're looking at those broadly, and each one will have small, positive effects. There will be no one breakthrough or silver bullet.

Ellie Mertz

I would just add, as we say in the letter, we're obviously opened to other people billing on our behalf. But also in Latin America, we're looking to improve the payment options that we offer to the consumers and solve the problem ourselves.

The letter said you were looking to expand into additional European markets beginning in Q4 of this year. If you can't be more specific, can you talk about the characteristics of that market?

Reed Hastings

I think that's probably just a duplicate question, so let's just go to the next one.

Ellie Mertz

What is the incremental impact of your decision to enter another international market on the expected full year results for 2012 on a consolidated basis? Should we see an investment along the lines of Latin America and the U.K. or smaller?

David Wells

We haven't provided guidance on that. What I said earlier was that we would be looking to fight back to a global consolidated breakeven after the market launch in Q4.

Ellie Mertz

How are you funding the entry and expansion into each country? And how many additional countries planned for this year and next?

Reed Hastings

Well fundamentally, we're funding it with the domestic profit stream. So our domestic business is showing great new growth in both revenue and contribution margin. And so we're using those profits to fund the international expansion, and it's needed by that by our view of staying approximately breakeven on a global basis.

Ellie Mertz

Has your view of international competition changed in recent months?

Reed Hastings

No, not particularly. We anticipated that in markets that we don't get to for a few years, there will be stronger local competition than in markets we get to soon. So I think that's probably pretty obvious. That's really the only aspect of it.

Ellie Mertz

Do you expect to see any different seasonal patterns in international markets? I know they're not showed today because of the high-growth phase you're in. But I would still like to know if there are any quarters with tailwinds or headwinds?

Reed Hastings

Well, from a diversification standpoint, if we were as big in the southern hemisphere as northern, they would balance each other. So it's definitely linked to the length of the winter, length of the night. And it would be -- and is reverse seasonality from the northern hemisphere and the southern. But on a practical basis, with the U.S. just under 90% of the business, it's the dominant aspect of the U.S. seasonality.

David Wells

And I would say that the pronounced weather pattern is one aspect of it. But as we contemplate other markets, we look at the seasonal TV viewing behavior, the seasonal rental behavior on video-on-demand and things like that. I mean some of these countries are tropical. They don't have a pronounced winter or summer, and they may follow the same pattern in terms of the northern hemisphere, but it's early to tell.

Ellie Mertz

While the sub trajectory in the U.K. appears far better than in Latin America initially, can you give us a sense of what usage looks like? How much time are U.K. subscribers spending with the service?

Reed Hastings

Usage has been very strong. I don't want to give, for competitive reasons, specific numbers. But we've been very pleased with the active usage and growing usage as we add more and more content and continue to flush out the devices in particular to getting on the Smart TVs.

Ellie Mertz

Moving to some questions on DVD. Why are you so confident that the DVD will not fall off as fast going forward as it is in the past couple of quarters? Even if churn is going down, is it not getting hard to find new gross additions for DVD films?

David Wells

We're confident because the retention of those subscribers are -- is improving from Q4 to Q1, and we may see some seasonality around Q2. But in general, the number of subscribers we're losing on the hybrid side are not the step change that we experienced from Q4 to Q1, largely because people were deciding whether or not they wanted to pay $16 for a hybrid service when we made the changes in July and they sort of rationalize those decisions over Q3 and Q4. So increasingly, fewer and fewer people are having to make that decision or have already made that decision about whether it's a value to them to pay $16 for the service, and that's what drives largely the sort of decreasing rate of decline.

Ellie Mertz

With the Qwikster episode fresh in mind, but also considering the high overall cost of DVD shipping, would you consider spinning off or selling the DVD division? The cash could be put towards faster overseas expansion, maybe the DVD and streaming services could still be tightly coupled with the right contracts in place?

Reed Hastings

No, we're not thinking of that.

Ellie Mertz

Moving to some miscellaneous questions. Are the terms of your Apple TV deals, the new member sign-ups, similar to the 30% revenue Apple has with other content providers?

Reed Hastings

Those type of contracts we're prevented from commenting by confidentiality, so we can't say.

Ellie Mertz

In late November, you announced the closing of $200 million worth of convertible notes, and those could be converted after 6 months assuming certain conditions were met. The 6th month anniversary will end during the second quarter. Given that the shares appeared to be above the conversion price, do you expect these shares to be converted? And if so, when?

Yes, so the first convertible, 6 months after its issuance which was November, which places us in May, the company has the option of converting those shares at 30% over the conversion price, which is about $11. And the earliest we could do...

Reed Hastings

$111.

Ellie Mertz

$111. Thank you. The earliest we could do that would be July if the stocks had stayed above that price for 50 of the prior 65 trading days.

What should we assume for forward tax assumptions?

David Wells

Around 38%.

Ellie Mertz

And higher in Q2?

David Wells

Correct, sorry. It'll play a little bit as we...

Reed Hastings

We should be so lucky to be paying taxes.

David Wells

I was just about to say that, that rate moves around a little as we come from a loss into a profit perspective at around 38%.

Ellie Mertz

Great. That's all we have right now for email questions. So at this time, I'd like to turn it back over to the operator and we'll begin taking live call-in questions.

Operator

[Operator Instructions] Our first questioner in queue is Jason Helfstein with Oppenheimer.

Jason S. Helfstein - Oppenheimer & Co. Inc., Research Division

I'll ask 2 questions and I'm not sure what was hit. With respect to what you talked about with Apple TV now taking sign ups from the TV, should we assume that you're paying similar 30% revenue share with Apple and that's kind of taking into account when you think about adding customers that way? And then my second question, you kind of had a positive take on the social integration, the U.K. and Ireland, but didn't give any specific metric. I'm wondering if there's any other type of metrics you can give out for us and maybe what percent of users are uptaking the social functions?

Reed Hastings

Jason, it's Reed. We did just answer the Apple question, which was no comment. And then on the U.K. Facebook success we've had, we haven't characterized any specific metrics, and for competitive reasons, we're not further elaborating.

Jason S. Helfstein - Oppenheimer & Co. Inc., Research Division

And then maybe one other follow-up. That functionality offering in the U.K., is that more a passive functionality? So does it seem like a Spotify or is an active sharing functionality with users prompted each time to decide whether or not they want to share their viewing habits?

Reed Hastings

It's passive in the way that you used that word like Spotify U.S. if you're using that where your viewing history is optionally shared with your friends.

Operator

Next questioner in queue is Mark Mahaney with Citi.

Mark S. Mahaney - Citigroup Inc, Research Division

Two questions. I think, Reed, last fall in reaction to some of the controversy, I think you made a statement that you think it might take a while for the brand and the relations and the trust with consumers to build back up. When you think about your DVD, streaming net adds goal of 7 million for the year, what you've done year-to-date, do you think you've already overcome some of those concerns that backlash from the fall of last year? Or do you think that that's still a subdued growth number that you could do better once you've regained the full trust of consumers? And then could you just quickly talk about usage on tablet devices and if that's had a material impact on those overall viewing minutes?

Reed Hastings

The brand recovery is partway complete. We had said it would probably take 3 years with the bulk of the recovery in the first year. That still seems to us to be the correct model. So we're feeling good about the progress we've made. We do -- we are conscious that it's tender and that we have to be extremely diligent and thoughtful in the way that we act as we build back our brand reputation. And then in terms of tablet, it's a great and growing viewing source for us, but we haven't characterized with any specifics any of the particular devices, again, for competitive reasons. We are on both Android and iPad.

Operator

Next questioner in queue is Richard Greenfield with BTIG.

Richard Greenfield - BTIG, LLC, Research Division

With consumers using Netflix so much, I think the numbers you broke out essentially equate to over an hour per day actually now. Shouldn't churn be going down meaningfully? When you made that comment about in 2012, if you added 7 million subs assuming flattish churn, why shouldn't we see churn go significantly down now that usage per customer per month or even per day just continues to scale upwards? And if just as a follow-up to that, can you just give us some sense on where subscribers canceling now, what is the main reason people are canceling the streaming-only service?

Reed Hastings

So Rich, the average consumer is watching, as you said, nearly an hour a day, and then they're not canceling. So the cancelations is amongst the people who aren't watching much. So our job is to get those light users that are not very active to be watching more. And the other phenomena is as the service gets better known and more popular, that expands the circle of people who join it, who maybe aren't as much in entertainment as the initial 20 million or 25 million. And so it's natural that as the service expands its reach, that there is continued churn as people try it, figure out if it's for them right now and if not, they get off. So that's where that phenomena is from.

Richard Greenfield - BTIG, LLC, Research Division

Does that imply that the median is dramatically above the mean in terms of usage?

Reed Hastings

No. It's just that it's -- it's not exactly a bell curve because it's got the skew on the big end. But it's the median is not wildly different. It's just that there will be 20% of people that don't watch much, and most of the churn will come from them. And you asked the question, when people quit, what do they cite? And the 2 big ones are not watching enough and don't have any money, which we see also.

Richard Greenfield - BTIG, LLC, Research Division

And when you say not watching enough, is that just because the programming, they can't find something they like? Or there just isn't enough content in total?

Reed Hastings

It's a mix of those. If you think about the moments of truth for a member, at any point in time, they can watch Netflix or they can watch cable or they can watch their DVR, they can watch a DVD or they can watch Hulu. And we have to win enough of those moments of truth to keep the subscriber active. And one of the ways we win is that a really broad selection, personalization, ease-of-use and otherwise it's just a habit, like being able to see the red Netflix button on the remote control.

Operator

Next questioner in queue is Anthony DiClemente with Barclays.

Anthony J. DiClemente - Barclays Capital, Research Division

Reed, you just mentioned that one of the big reasons for churn is people not having any money. So I wonder if you would consider that if extreme picks, for example, of $4.99 and let's say Amazon comes out with a carve-out prime streaming service at something lower than $7.99, have you thought about or would you consider adjusting your price point? And then the second question would be, I think Mark asked about usage on tablets. And I would just ask, has the subscriber acquisition channel changed with the explosion in mobile? Is that something that you can comment on in terms of where you're getting gross add connects from? That would be great as well.

Reed Hastings

We're feeling great about our $8 dollar price because we can then get lots and lots of content for our subscribers, so no anticipated changes there. And then in terms of subscriber acquisition, mobile is a good source for us. Video is disproportionately watched on television. So things that are TV-based sign-up, like on the game consoles, like Apple TV are really the brand center and the biggest drivers of potential opportunities.

David Wells

Anthony, this is David. That hasn't changed, right. That's consistent with what we've said in prior quarters, and that's not a big acquisition driver. It's a big value driver for our subscribers.

Operator

Next questioner in queue is Heath Terry with Goldman Sachs.

Heath P. Terry - Goldman Sachs Group Inc., Research Division

I was just wondering if you could give us a sense of what, just purely on a relative basis, if you see any difference in the levels of churn between your users that are engaging you through multiple devices like connected television sets, tablets, handsets versus your more PC or kind of game console customers?

Reed Hastings

Yes. It's exactly is your intuition is probably leading you, which is if you use Netflix on lots of devices and if you use it for lots of time, you're more engaged with the service and you are less likely to churn. So that's definitely an indicator.

David Wells

Heath, this is David. Teasing out people who don't use it a lot but have a lot of connected devices, that's probably not a common case. So people who use a lot of devices tend to watch a lot of hours.

Operator

Next questioner in queue is Doug Anmuth with JPMorgan.

Douglas Anmuth - JP Morgan Chase & Co, Research Division

Just wanted to ask about the deleverage in the DVD business. I mean is that just purely about the declining sub numbers, or is there anything else we should be thinking about here? And how are you thinking about distribution centers going forward? And any other costs you may be able to take out of the business along the way?

David Wells

This is David. I'll take that one. I would say that in general in the DVD business, the big driver is the rate of subscriber decline. There's some other smaller things out there like postage rates and the fact that we would expect an annual postal increase going forward, which we have in the past. I would say the other aspects are there's some minor things on just as you reduce shipments, you lose some scale advantages, but those are small relative to the subscriber decline. And that's why we put in the letter that we would expect that the margin would stay relatively flat through 2012.

Operator

Next questioner in queue is John Blackledge with Credit Suisse.

John R. Blackledge - Crédit Suisse AG, Research Division

Two questions. The first one is, do you feel like the 7 million net domestic streaming add guide is a comfortable target? And did you guys consider maybe giving a range for the year similar to the range that you gave on a quarterly basis? That's one. And then the second one is, what's the demand for personalized accounts domestically, and is that something we may see introduced at some point?

Reed Hastings

John, yes, we're feeling comfortable on the 7 million, and you could put a range on it if you want, but it doesn't really change the goal. So we were just being straightforward about what our goal is. And in terms of the personalized accounts, that's something that we're developing a number of versions of. We'll be doing some consumer testing with different versions of that going forward. But there's unlikely to be any revenue associated with that, and that is we're most focused on how do we improve the experience and we'll see that in retention and acquisition at this point.

Operator

Next questioner in queue is Scott Devitt with Morgan Stanley.

Scott W. Devitt - Morgan Stanley, Research Division

Just wanted to ask the 7 million sub question a different way. When you go back to 2010 when you added the 7 million subs you had 2 things, the bundled product at $9.99 and pretty significant distribution tailwind because of mostly the game consoles that were coming online and just starting to benefit the business. So when you look at that 7 million number for '12, what are you thinking are the comparable catalysts that give you the comfort to get to that type of sub numbers for the year?

Reed Hastings

Scott, I would say it's mostly based on how we did in Q1 and then which helps us feel good about being on track for that 7 million. And then secondarily, in terms of the macro climate, it's the increased integration with Smart TVs. So if you go into a Best Buy today, we've got a stronger presence than we've ever had in the integration with both Smart TVs and Blu-ray.

Operator

Next questioner in queue is Barton Crockett with Lazard Capital Markets.

Barton E. Crockett - Lazard Capital Markets LLC, Research Division

One quick one and then one broader. To understand the net income view for the balance of the year, when you talked about global breakeven with the fourth quarter launch of an international market, is that breakeven for the fourth quarter or breakeven for the year?

Reed Hastings

You can think about it as breakeven on some rolling basis or approximately breakeven on some rolling basis, or it's -- we'll go under and then come up and go under and then come up. But ordinarily and when I made that comment, it was on the quarter.

Barton E. Crockett - Lazard Capital Markets LLC, Research Division

Okay. So you're not saying breakeven for the year. You're not really saying anything about the year, I guess, at this point?

Reed Hastings

That's correct.

Barton E. Crockett - Lazard Capital Markets LLC, Research Division

Okay. And then I was also wondering, the surge in streaming usage, you guys ever have had your -- a very significant share of prime time hours streaming content. Are you seeing any noticeable deterioration in quality of service to consumers? There are cable companies that warned about brownouts in hours as you see video surge. There's another streaming services coming up. Do you see any negative performance to the quality of your service, or do you anticipate anything as your usage ramps as others ramp?

Reed Hastings

Barton, the technology underlying the Internet and fiber optics is absolutely mind blowing. So you can take our peak viewing on a Saturday night, 100% of our global viewing, and it can still fit into a single fiber optic. So I don't anticipate any brownouts. I anticipate continued growth of the broadband power being released as more and more become -- we become a fiber optic nation and a fiber optic world.

David Wells

I would add to that, Barton, that you're starting to see the ISPs compete on speed. It's in their ad -- prominently featured in their advertising. So it would feel a little inconsistent to be trying to advertise and compete on speed at the same time warning your consumers that you're going to face shortages of the product.

Ellie Mertz

Great. That's all the time we have for questions today. I'm going to turn it back over to Reed Hastings for some closing remarks.

Reed Hastings

Well thanks, everyone. As I've said in the beginning, we had a great Q1. We were thrilled by it in terms of our U.K. launch, in terms of our growth around the world, in terms of getting to great viewing records in Q1, and we're on track for breaking those records in Q2 on a year-over-year basis, so we're excited about that. The odd thing about our numbers, I realized, is that with stable seasonality in gross adds, we see increased seasonality in net adds, and that is this mathematical artifact that we try to document. I know it's got some people concerned, but we feel great about our progress and being on track for our 7 million net adds for the year.

With that, I want to thank everyone for being on the call and look forward to catching up with you.