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

Ellie Mertz

Thank you, and good afternoon. Welcome to the Netflix Fourth Quarter 2011 Earnings Q&A Session. I am joined here by Reed Hastings, CEO; and David Wells, CFO.

We announced our financial results for the fourth quarter at approximately 1 p.m. Pacific Time today. The shareholder letter and the Q4 financial results and the webcast of this Q&A session are all available at the company's Investor Relations website at ir.netflix.com.

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

We may make forward-looking statements during this call regarding the company's future performance. Actual results may differ materially from these statements due to risks and uncertainties related to the business. A detailed discussion of such risks and uncertainties is contained in our filings with the Securities and Exchange Commission, including our annual report on Form 10-K filed with the Commission on February 18, 2011. A rebroadcast of this Q&A session will be available at the Netflix website after 6 p.m. Pacific Time today.

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

Reed Hastings

Just jump over to questions, Ellie.

Ellie Mertz

All right, let's move directly to questions.

Question-and-Answer Session

Ellie Mertz

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

David Wells

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

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

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

David Wells

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

Ellie Mertz

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

Reed Hastings

Well, that will vary by market and maturity. What we think about it as, as contribution margin and contribution profit. And as we talked about, we did better in Q4 than we expected, and so we're taking up our target for 11% for Q1 for contribution margin in the U.S. In our different international markets, we're still contribution margin negative. And that's -- the losses will abate in each market as it grows and breaking into contribution margin positive.

David Wells

And I think for longer term, we'll -- there's only 2 buckets. There's content expense and marketing. And so if we're going to expand our contribution margin, our profitability long term, we'd be looking to leverage some of that content long term as well.

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

Well, HBO spends about 1/3 or 40% of their budget on original and the rest on already produced movie content. So that would be the high watermark. And they do a great job on those originals. We're starting much more modestly with our originals. Some of it will judge by how much it gets viewed by the -- and how much it costs. Is it an efficient source of programming? And some others in terms of does it attract and build -- attract new subscribers and build the reputation for Netflix? And today, it's a modest part of our budget, and we'll keep it as a modest part of our budget until we learn more as we go year-by-year.

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

Final question on originals. Can you please talk about how accounting for these series will work? And under what scenarios are write-downs possible?

David Wells

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

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

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

David Wells

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

Ellie Mertz

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

David Wells

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

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

I don't think there's a lot of brand strength in being -- to use the "everything for everyone." You gain profit and brand strength from being something important and precise. And we believe that unlimited for a low fee in the USD $7.99 a month is the core of our brand proposition and that if we were to add pay-per-view, it would be at a negative. It would confuse the brand. And there is a number of providers, Wal-mart's Vudu, Apple's iTunes, Amazon Unbox, Best Buy's CinemaNow, Blockbuster, the list just goes on and on of providers who already offer pay-per-view. And we have no way to do it better that we know of. So what we're focused on is instead working with all of those partners and keeping the clarity of our brand. So our strategy is to -- essentially, you can think of it like Dolby Digital is, be in every platform and get along with everyone. And we believe that there's a large enough market at a $8 unlimited subscription to have us grow very large. So to some degree, it's a niche strategy, but it's a very large niche that we think we can lead. And so that's why our focus is exclusively on unlimited. And we're not at all nor have we ever been interested in pay-per-view.

Ellie Mertz

What does content underspending mean as it relates to margin impact on streaming in the fourth quarter 2011?

David Wells

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

Ellie Mertz

All right. Let's move to questions about international. I know it's early, but what have you seen so far from international? Is there a case that can be made one way or the other about the relative profitability long term for a U.S. versus a non-U.S. subscriber?

David Wells

I'm sorry, repeat that one more time.

Reed Hastings

I'll take it. The profitability of a subscriber is based upon the barriers, competitive barriers on a relatively scale. So in any market in which we have very strong scale advantage, we'll have higher profitability. In any market where, for example, there's 3 roughly equal-sized firms, then we would have less profitability. So it's not so much U.S. versus non-U.S. It's relative scale in each of the markets. And that's part of why we're investing so aggressively to be early and to lead this market in as many markets as we can.

David Wells

And the only thing I'd add to that is it's also about relative consumer offerings in that market or competition. So between the scale and the available consumer offerings, it would be those 2 things.

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

Looking at Latin America, there are some key differences in terms of income levels and broadband penetration rates. Is there anything about Latin

America that indicates the region may achieve profitability faster or slower than a region like Canada? How should we think about the cost of content deals in Latin America compared to the U.S. and Canada?

David Wells

So Latin America, you can infer from our discussion in the earnings letter, both from our net additions in this Q4 for international versus last year, is growing slower than Canada did in its first quarter launch. I'd say that we're building a new brand in Latin America where we had much more of a U.S. halo brand effect in Canada. And device penetration in Canada was higher than it is in Latin America. Those 2 things are turning out to be important. So I think Latin America is a good and perspectively a great market for us going forward, but it does look like it's going to be on a path slower to profitably than Canada. And then the second part of your question dealt with -- can you ask that one more time?

Ellie Mertz

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

David Wells

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

Ellie Mertz

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

Reed Hastings

It's early to say. But on balance, I guess, yes, that it will take us longer than 2 years. So we're working hard on all of our payment issues and subtitling issues, rapidly improving them, and then we'll be able to see what's the underlying growth trajectory. So it's not out of the question, but I would say the odds are it will take longer than 2 years. And I'll point out that the 2 years is a bit of a aspirational arbitrary benchmark. If you look at DIRECTV, it took them a number of years to gain their market position, and now they have an extremely valuable franchise. So mostly, the 2-year goal is a great internal goal because we want to turn around that money and invest in the next market. But the fundamental -- really get a return on it is we feel very strongly about where the growing economies in Latin America and our strong relative competitive position that we can build a very valuable franchise in Latin America.

Ellie Mertz

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

Reed Hastings

Well, definitely, pricing is not an issue. We're very aggressively priced. For example, MXN 99 in Mexico. Most of the content viewing is Hollywood content, and that's how we've programmed. And then we complement that with the telenovelas.

Ellie Mertz

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

David Wells

So I think it's back to my earlier comment about the available monetization channels that the content owner has and if piracy depresses those, then the cost of the content is lower because their ability to monetize the content in-market is lower.

Ellie Mertz

Why do you dismiss Web film [ph] so quickly as DVD-only?

Let me take this one. Historically, Web film [ph] has been predominantly focused on DVD. Streaming is really something that they're only in the early stage of, whereas we've been focused on streaming for 5 years now. And so if you look at the services, we're better, faster and easier to use in the U.K. So we expect they'll likely be -- continue to be successful in the DVD-by-mail and the hybrid segment of the market, which for us domestically is about 40%. And if you just look at how they're offering the service today, they came out with a strong streaming-only offering around the time of our launch, and yet it's still very difficult to find on their website. So we'll continue to monitor them. But I think we have a leg up in terms of our streaming experience.

Now that you're operating in 4 distinct regions: U.S., Canada, Latin America and U.K./Ireland, is there a need to favor one specific region over another in terms of allocating the content spend?

David Wells

No, there's no such need.

Ellie Mertz

Why did international freeze subs decline quarter-over-quarter? Is it normal seasonality?

David Wells

So I think the reference in terms of international freeze, if you take the total less...

Reed Hastings

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

David Wells

Right. So seasonal with the launch.

Ellie Mertz

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

David Wells

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

Ellie Mertz

I think it's safe to say that our losses will obviously be dependent on subscriber growth and the revenue that we generate from that growth.

Let's move to questions about DVD. If the DVD business continues to decline, would you look to consolidate warehouses? How do you expect closing of post offices to impact shipment time?

Reed Hastings

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

Ellie Mertz

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

David Wells

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

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

David Wells

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

Ellie Mertz

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

David Wells

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

Ellie Mertz

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

Reed Hastings

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

David Wells

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

Ellie Mertz

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

Reed Hastings

Yes. That's a very articulate description.

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

Not sure on their content strategy, depends on how much they want to spend.

David Wells

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

Ellie Mertz

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

Reed Hastings

I don't have any insight on an Apple TV. But there is a small 3 inch by 3 inch box called Apple TV that Apple invited us on about 2 years ago, and it's been very successful for us. We've just updated that application, making it even better, adding a great Netflix for Kids interface on it. It's now throughout Latin America, and we expanded the agreement with Apple for the U.K. and Ireland. So we're working really well with the current and existing Apple TV.

Ellie Mertz

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

David Wells

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

Reed Hastings

And there's very little margin impact for more usage. It's only in the CDM [ph] fees, is the only place where that exists.

Ellie Mertz

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

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

Reed Hastings

And it's continuing to fall.

Ellie Mertz

Any impact to cost from the Durbin Amendment?

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

David Wells

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

Ellie Mertz

Going forward with international mix, what are your assumptions on the blended tax rate for Q1 and all of 2012?

David Wells

Q1 will be 39%. We continue to be pretty close to a full tax rate payer. It's unknown whether the R&D tax credit will be renewed this year. My guess will punted through until the end of the election. And if it behaves similarly to 2010, if it isn't adopted, they'll probably make it retroactive, and we might have a similar tax pattern to 2010. Which means that we'll have 38%, 39%, and then there'll be a low rate catch-up in Q4.

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

Is there an update on when you expect the app to be available to U.S. members?

Reed Hastings

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

Ellie Mertz

Do the international test to date provide meaningful data in terms of the average boost to new subs, increased fees ensuing from existing subs, et cetera?

Reed Hastings

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

Ellie Mertz

Move to questions on devices. Apple sold 16 million iPads last quarter. But in the past, you have said you don't believe that tablets are a subscriber acquisition channel for Netflix streaming. Do you think that the faster, out-of-home bandwidth speeds would possibly convert tablets into bigger subscription -- into a bigger subscription acquisition channel?

Reed Hastings

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

David Wells

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

Ellie Mertz

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

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

David Wells

Yes. I'd say that hindsight's easy. Given the same facts, I'd make the same decision. And the relative dilution is unfortunate. We'll work a little harder. But otherwise, we're in a much stronger position.

Ellie Mertz

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

Operator

[Operator Instructions] Our first question comes from Rich [ph] Greenfield from BTIG.

Richard Greenfield - BTIG, LLC, Research Division

A couple of follow-ups. One, Reed, when you initially were going to separate the 2 plans with Qwikster, you had talked about investing in the DVD business, and that's part of the reason you were doing it, was to invest in that business because you thought it had a long life. And it seemed like -- the comment you made earlier, you made it seem like the DVD business is something you're not going to put a whole lot more emphasis on from an investment standpoint. I'm just -- does this all relate back to the fact that the DVD business is actually now declining? I mean, do you expect stand-alone DVD subs to be down each of the quarters throughout 2012?

Reed Hastings

Yes, Rich]ph]. We expect DVD subscribers to decline steadily every quarter forever.

Richard Greenfield - BTIG, LLC, Research Division

But even -- because the stand-alone subscribers I think actually we're up in Q4. And so now you actually think that now that the shift from hybrid to stand-alone DVD had subsided, the net effect will be stand-alone DVD-only subscribers going down quarter after quarter?

Reed Hastings

No. We don't think about it as stand-alone versus hybrid. There's just DVD subscription to DVD subscriptions, which are 11 million at the end of last year, are going to decline steadily essentially forever.

Richard Greenfield - BTIG, LLC, Research Division

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

Reed Hastings

The average American household watches 8 hours of TV a day. And the average investor does not watch 8 hours of TV a day. So there's -- when one looks at one's own personal behavior, there is a big disconnect, I would say, relative to median or typical Americans which is, at over 20 million subscribers, is most of our market. And so if there is a disconnect, that might be the reason why.

Operator

Our next question comes from Jason Helfstein from Oppenheimer.

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

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

Reed Hastings

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

David Wells

55.4 million was the diluted share count at the end of the quarter. And I'll just...

Reed Hastings

And that's in the letter -- investor letter, obviously.

David Wells

Yes. It's on the first page of the letter.

Operator

Our next question comes from Anthony DiClemente from Barclays Capital.

Anthony J. DiClemente - Barclays Capital, Research Division

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

Reed Hastings

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

Anthony J. DiClemente - Barclays Capital, Research Division

It can maintain a direct relationship with Warner.

Reed Hastings

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

Operator

Our next question comes from Mark Mahaney from Citi.

Mark S. Mahaney - Citigroup Inc, Research Division

The comment about underspending in marketing in Q4, could you just provide a little more color around that with our new found efficiencies? Or was that just a timing issue?

David Wells

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

Operator

Our next question comes from Mike Olson from Piper Jaffray.

Michael J. Olson - Piper Jaffray Companies, Research Division

So you said in the letter that you won't add new geographies until you return to profitability. Is that global profitability on a quarterly basis or full year? So I guess in other words, if you [indiscernible].

David Wells

Quarterly.

Operator

Our next question comes from Scott Devitt from Morgan Stanley.

Scott W. Devitt - Morgan Stanley, Research Division

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

Reed Hastings

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

Scott W. Devitt - Morgan Stanley, Research Division

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

Reed Hastings

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

Scott W. Devitt - Morgan Stanley, Research Division

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

Reed Hastings

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

David Wells

And if there's more substitution between those 2 rather than complement.

Reed Hastings

Exactly.

Operator

And our next question comes from Matt Schechter from Bank of America Merrill Lynch.

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Matt Schechter - Center for Financial Research & Analysis, Inc.

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

Reed Hastings

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

David Wells

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

Matt Schechter - Center for Financial Research & Analysis, Inc.

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

David Wells

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

Operator

Our next question comes from Doug Anmuth from JPMorgan.

Douglas Anmuth - JP Morgan Chase & Co, Research Division

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

Reed Hastings

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

Douglas Anmuth - JP Morgan Chase & Co, Research Division

Okay. And if I could just follow up with one more. Could you just clarify why there's no deleveraging the DVD business if you have to continue to operate the warehouses around the country?

Reed Hastings

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

David Wells

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

Operator

Our next question comes from Andy Hargreaves from Pacific Crest.

Andy Hargreaves - Pacific Crest Securities, Inc., Research Division

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

Reed Hastings

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

Andy Hargreaves - Pacific Crest Securities, Inc., Research Division

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

David Wells

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

Andy Hargreaves - Pacific Crest Securities, Inc., Research Division

And when does it become eligible for that, David?

David Wells

When it's -- in 6 months.

Andy Hargreaves - Pacific Crest Securities, Inc., Research Division

So 6 months from issuance? Mid-November?

David Wells

Right.

Operator

Our next question comes from John Blackledge from Crédit Suisse.

John R. Blackledge - Crédit Suisse AG, Research Division

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

Reed Hastings

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

Ellie Mertz

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

Reed Hastings

And I feel obliged, since I just got back from Sundance, to give you 2 movie recommendations to end the call on a light note. Both The Surrogate and Beasts of the Southern Wild hopefully will get picked up and distributed and everyone will be able to see them. They're fantastic movies. And I'll try to make sure they're on Netflix for all of you, too. Thank you, everyone.