

Welcome to the Netflix Q1 2016 earnings call. I'm David Wells, CFO. I'm joined today by Reed Hastings, CEO, and Ted Sarandos, Chief Content Officer. Interviewing us today will once again be Ben Swinburne with Morgan Stanley and Peter Kafka with Re/code.

Just a warning before we begin that we will be making forward-looking statements, actual results may vary. I think, Ben, you have the first question, so over to you.

Question-and-Answer Session

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Sure, thank you. Maybe you can start out by just reflecting on the quarterly results you guys just delivered relative to your expectations. And maybe you could start out in the new markets you launched at the beginning of the year and how those performed relative to your expectations.

Wilmot Reed Hastings - Founder and CEO

Sure. We were incredibly excited to grow to over 81 million subscribers. It's an enormous quarter for us that way. Some of it was from our expansion around the world. It's 130 countries. So there's quite a bit of variety. And remember that most of those countries we haven't yet seen the full potential of, because we're only in English and only with international credit cards. So over the next couple of years, as we further localize, we'll be able to see more opportunity. But by going so broad, we've increased our rate of learning, and so, we're really excited about the approach and looking forward to the rest of the year.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And how did you feel the U.S. markets behave this quarter versus your expectations? You had noted in the letter a lot of strength from the originals that came in ahead of expectations. I'm guessing that's on gross connects, but how do the originals perform even relative to what I'm sure where your fairly bullish expectation is in the U.S. market.

Wilmot Reed Hastings - Founder and CEO

Well, in the U.S. market, we did about 2.25 million net adds, which is nearly identical, not only to last year, but to the year before. So what you see is this continued growth and we're thrilled to keep that growth steady, between 5 million and 6 million net additions. And the content just keeps improving and that keeps the word of mouth growing. So we're very excited about that formula and what we saw in Q1.

Peter Kafka - Re/code

Reed, you guys have been watching Amazon for a long time. You compete with them at least on content for quite some time. Four years ago, you predicted they'd come out with a standalone servers priced under yours. They announced that yesterday. What's your view of them now, and in particular, with the announcement they made yesterday, do you think they're trying to compete head-to-head with you for subscriber dollars, or are they trying to underscore the value of Prime overall.

Wilmot Reed Hastings - Founder and CEO

Hulu is doing some great work. Amazon is, HBO, Showtime. There are so many competitors, and everyone is working hard to build the best content. And so, we're seeing growth in the overall Internet TV market. Of course, that's displacing linear TV, and it's natural that everybody is coming in as they realize that the future is Internet TV. And in terms of our shows, we're very excited about what we're doing. Not only are we expanding the number of original series we're doing, but we're also expanding into original movies.

So again, this is all part of the natural evolution from linear TV to Internet TV.

Peter Kafka - Re/code

Amazon has been talking with programmers for a while about adding linear channels. So you're looking at a scenario where they might have an offering that's similar to yours for the on-demand stuff, with a mix of originals and older movies and TV shows, plus current content live. What does that look like to you in terms of the prospects of competing against that head-to-head?

Wilmot Reed Hastings - Founder and CEO

We're very focused on global competition. Obviously, around the world, it's very fast growing for us. We're coming towards 50/50 International, Domestic revenue. And so, we're focused on content that we can have around the world, which is why we're investing in original movies, original series so that we can have that content and also producing around the world like our French series Marseille or Spanish in Narcos.

And that's very different from carrying other people's single nation networks. So that's just a very different business. It's not one we focus on a lot. We know what we want to be, which is a great global producer and distributor of content, and other people will do other things and that's fine. They may be very successful.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Let me throw a question out for David and/or Ted about – thinking about the second quarter guidance internationally, there's a lot to chew on there. The number you laid out is probably below where most people were expecting. I'm wondering if you could talk, David, about how you thought through putting the second quarter guide together around the seasonality, some of the comp issues you talked about in the letter and whether we're seeing a more earlier than expected level of seasonality in some of these markets that are still one year or two years old.

And Ted, there's a narrative out of Europe, in particular, that the incumbents are sort of teaming up against you from a content perspective, and you've got a lot of stuff coming down the pike on originals. So if you could talk about your relationship with suppliers overseas since that's probably an area people have spent less time thinking through.

Theodore A. Sarandos - Chief Content Officer

Sure, I let David kick it off there to go first.

David B. Wells - Chief Financial Officer

So, Ben, in terms of thinking about the guide, just a reminder that we put in the letter that absent the strong performance that we saw last year from a very recently launched Australia/New Zealand market, our guide would have been up. So I think you haven't yet seen sort of a normalized pattern of growth from us, in terms of a year-on-year growth expectation across our international markets, because we've been layering on new markets as we go.

So I think, from our perspective, we were super happy with the results of Q1. And we wanted, in Q2, that to continue and it is, but we're mindful of the fact that we've got these large blooms of launches last year, and then, in Q1 this year with the rest of world markets, the Netflix global launch that are going to continue forward, because they're addressing pent-up demand.

So for us, we're focused on continued growth in those markets and that's what we're seeing. And we're focused on continued improvement from an economic sense of reducing those losses and this year, you're seeing us continue to invest, but the U.S. is growing. So overall, operating profit is improving as we go and into next year.

Theodore A. Sarandos - Chief Content Officer

I just say the reaction from the broadcasters across Europe is not different than it's been anywhere else. There's always uncertainty when we come to the new market, what role we're going to play, how complementary we're going to be versus competitive, and I think everyone just likes to weigh all their options in terms of their competitive strength. We're buying a lot of pan-European rights as part of our global acquisitions, which I think probably makes them a bit nervous too while they're trying to figure out what their next moves will be. But again, I don't think it's that unusual, even here in the U.S., where three of our largest suppliers teamed up to create Hulu, with probably much of the same motivation.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And just as a follow-up, there's I don't think any mention of VPN changes in the letter, but that obviously has happened. Is that impacting at all the second quarter guidance at all?

Wilmot Reed Hastings - Founder and CEO

No, that change was in the first quarter. It's a very small but quite vocal minority. So it's really inconsequential to us, as you could see in the Q1 results.

David B. Wells - Chief Financial Officer

And the only thing I'd add to that, Ben, is we were able to grow. In the first quarter, we had very strong U.S. growth. At the same time, we had a very robust Netflix global launch. So I think it validates the fact that we're seeing new demand for Netflix in those markets.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Sure.

Peter Kafka - Re/code

This is for Reed. You keep getting asked this, but I want to keep asking because the question keeps coming up. Any interest in live sports in any capacity?

Wilmot Reed Hastings - Founder and CEO

Any interest in what?

Peter Kafka - Re/code

Live sports.

Wilmot Reed Hastings - Founder and CEO

Live sports. Ted, I'll let you handle that question. It worked so well for us last time. We knew this.

Theodore A. Sarandos - Chief Content Officer

Exactly, there's no interest in live sports currently.

Peter Kafka - Re/code

Currently. What about live in general? There's a lot of interest, Twitter, YouTube, Facebook in particular, and the idea of broadcasting live video over the Internet. You guys have tweaked your model a little bit or will be tweaking a bit with Chelsea Handler where you're going to move away from the dumping out all the stuff in one go and staggering it. So if you're not doing live – if you don't plan to do live now, why not consider it down the pike?

Wilmot Reed Hastings - Founder and CEO

So just to correct you, we have never dumped anything. We have given it a proper platform with all of the great content that it deserves.

Peter Kafka - Re/code

A full release.

Theodore A. Sarandos - Chief Content Officer

So Chelsea is near live in that we're going to be putting it up to our subscribers just a couple hours after it's recorded live in front of an audience. There's not a technological reason we wouldn't want to go to live. But you should think about our brand proposition is very much about on-demand. So to the extent that watching on-demand is better than watching live would bring a ton of value to it. And other people doing live, I think it's great. It's about a further expansion of Internet television to include live. We don't have to do everything to be part of that expansion.

Wilmot Reed Hastings - Founder and CEO

And rather than invest in things like live sports, we're investing in things like The Crown, which is just an epic production. And maybe you could talk a little bit about that, Ted.

Theodore A. Sarandos - Chief Content Officer

It's being shot right now in the UK. We have previewed some footage of it to the European press last week. They just loved it. It's a massive cast, a massive production that will tell the life of Queen Elizabeth, starring Claire Foy as the Queen and will follow her life through her relationships with the Prime Ministers all the way through to current times. So it's a very – it's those kind of things that we think are massively global that we can produce on a larger scale than anybody else that we really think we can win the day on.

Peter Kafka - Re/code

Thanks.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

David, coming back to the second quarter guidance again but on the U.S. market, why did you decide to delay or spread the un-grandfathering through the remainder of the year? You mentioned you don't expect much of an impact, but you decided to spread it out. And if you could, just walk us through what you've learned in your testing so far and the thought process around that.

David B. Wells - Chief Financial Officer

I think we've always been a testing company. So perhaps there should have been an expectation that this would be a gradual thing in terms of layering that out. We've got a number of markets that are coming off un-grandfathering, not just the U.S. And some of those are timed three to four months as we go. So I think it's just about messaging it. It was important to us to make sure that subscribers knew that this was happening and to put it in front of them, and that's what we're going to do. And we want to do that, do right by the consumer and do right by Netflix as we go. So I think we're just taking our time to do that.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And, Ted, what are you seeing in terms of the efficiency of your spend as you continue to build on originals? And I'm curious. You've had more data points around film results, and you'll have more coming up. How are the films performing relative to your expectations, and relatively maybe to the spending on TV series?

Theodore A. Sarandos - Chief Content Officer

The efficiencies are a little hard to match because you've got a couple of hours of viewing versus 10 to 13 hours of viewing on a series. But relative to

how we license other movies, we've been pretty happy with the direction that it's going. Remember, we have a few films under our belt. Where I'm really looking at is how broadly people engage with them, how do they play around the world. All those data points have been really positive. And as we keep going, I think that content can be as efficient as the series relative to other films. So we're still learning as we go though.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Thank you.

Peter Kafka - Re/code

Can you guys talk about your M&A strategy? Are you looking at Paramount, which may be partly for sale? What about Starz, which is unofficially for sale? And if you don't want to comment on those in particular, what do you think you might as you consider larger acquisitions?

Wilmot Reed Hastings - Founder and CEO

It's been 15 years we've been public and 20 years existing, and we've done no M&A. So I think that probably speaks for itself.

Peter Kafka - Re/code

And as you guys push into the studio film business, making your own movie, does it make sense to at least do a smaller acquisition that would help you get some of those competencies in-house?

Theodore A. Sarandos - Chief Content Officer

Peter, what you're seeing not just on the films, but also on several of our series where Netflix is increasingly the studio and the network on those shows. So we are building that efficiency in-house. The Ranch that just premiered a few weeks ago is a Netflix-produced show, and we'll be doing a lot more of those coming up.

Peter Kafka - Re/code

So you can build that without buying it.

Theodore A. Sarandos - Chief Content Officer

We're building it versus buying it.

Wilmot Reed Hastings - Founder and CEO

We'll just hire the people that we want and build it and that could in principle be a constraint on our rate of growth, but Ted's been able to attract an incredible team in LA. And so, when you look at the growth in our originals, you can see that we can deliver on that on this organic hiring basis, which of course is much stronger for the long term than if you tried to juice it with M&A.

Peter Kafka - Re/code

Thanks.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Reed, can you talk a little bit about how investors and shareholders should look at various opportunities internationally? For example, Brazil is a market that maybe at first blush wouldn't appear to be ripe for Netflix, given sort of low paid TV penetration, lower household income, lower broadband speeds and yet you've described that as a rocketship, you've done really well there. And yet maybe other more sort of developed markets in Europe have been slower.

What are the characteristics and things that are outside of Netflix's control that drive success? And what are the things you're doing that you maybe didn't do a year ago to make sure you capture the opportunity?

Wilmot Reed Hastings - Founder and CEO

One of the major things I think is eCommerce and payment systems to the degree that there's a convenient way to pay for airline tickets, for example, online. That's really helpful. But we're continuing to work with all the different ISPs, phone billing solutions, other things, and we'll grow as the payment infrastructure or the eCommerce infrastructure grows.

So when you think about it in the long term, everybody around the world is going to be watching Internet video, and we want to be well-positioned, so as all of these countries evolve towards Internet video that we grow with them. In some cases, that will be 10 years, 15 years, in other cases, it will be in the next two years or three years. But it's a long-term investment, and country by country, it's worked out extremely well for us. So that's why we're so invested in international expansion. We're very confident that in the long-term, everybody is going to be watching TV shows and movies over the Internet. And we hope to be one of the leading brands for that around the world.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And let me just ask you – go ahead, David.

David B. Wells - Chief Financial Officer

The only thing I would add to that too and I think Reed would say is you can't anticipate everything. And I think five years ago when we were first launching the markets, we thought maybe we could anticipate most things. But every time we've launched, there's been one or two things that we haven't anticipated. What we have gotten good at as a company is fast learning and fast improvement. And so, I think that gives us some confidence as well that as things come up, we'll be able to address them quickly.

Wilmot Reed Hastings - Founder and CEO

And remember, when you look at Facebook and YouTube, which are ad supported, but viewing and consumption is generally 80% International, 20% Domestic. And we've got a lot of International growth to go before we can aspire to that point.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And let me just pick up on a question Peter asked earlier that sort of talks about where Amazon's taking the bundle and take it from the perspective of incumbent MVPDs. You saw I'm sure, Reed, that Dish built another sling or is building another sling offer, sort of a low price point IP-delivered bundle of networks, DIRECTV is going to have three cheaper OTT launches later this year. You're starting to see these things proliferate more. Does that change sort of your competitive position as you think about sort of this big pricing umbrella getting smaller over the next year plus and becoming more IP?

Wilmot Reed Hastings - Founder and CEO

No, those are all single nation solutions and we're really focused on global content and expanding globally. And so, I don't see really that much nexus between them. Again, as we said in the letter, when you think about your own experience of what do you do some night if you're not watching Netflix? Once in a while, it's cable television. Once in a while, it's video gaming, it's browsing Facebook, killing time on the web generally. There's so much out there. So the only inhibitor in our growth is how great is our service, could we make it so there's never buffering so it always starts up instantly. So the recommendations are incredible, and the content is exciting. And if we can do all that, we'll continue to grow globally, even though HBO or Dish or others are also growing. So their growth doesn't take away from us.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Thank you.

Peter Kafka - Re/code

Reed, can you explain, just for the record, why you guys went ahead and sort of reduced the quality of streams on certain wireless carriers, and how that's different than the complaints you lodged against people like Comcast in the last couple of years?

Wilmot Reed Hastings - Founder and CEO

Sure, mobile generally has small data caps and very expensive per gigabyte charges, like \$10 to \$20 per gigabyte supplemental. And so, we wanted to save data for our users by using very tight and small encodes, especially when it's being watched on a 4-inch or 5-inch screen. And what we'll be adding going forward is an option so consumer can set, they want to do extreme data saving, moderate data saving, or no data saving at all. And so, we'll evolve to let the users just do it. But the advantage of doing it for people in the past was to save on – to avoid those data plan overages that are pretty unique to mobile.

Peter Kafka - Re/code

And that option you're describing where you can sort of opt in to sort of what quality you want, is that a reaction to the stories that came out in the last few weeks?

Wilmot Reed Hastings - Founder and CEO

No, we've added lots of options over time to allow more customization. If you look, we've had one on the wired side. We just hadn't implemented it yet or rolled it out on the mobile side. So it's always been planned.

Peter Kafka - Re/code

Another regulatory question or I guess FCC question. The open set-top box proposal that President Obama has endorsed, if that goes through, what sort of changes or options does that open up for you?

Wilmot Reed Hastings - Founder and CEO

For us, the open set-top is the Roku or the Apple TV or the Smart TV. It's a basic Internet device that runs apps, and that's what we think the future is, is that kind of broad openness. And we don't really follow very closely like the intricacies of the cable set-top industry in the U.S. as opposed to these great global platforms that are IP centric, like a Samsung Smart TV.

Peter Kafka - Re/code

So it's not meaningful to you if it goes through?

Wilmot Reed Hastings - Founder and CEO

I don't think so.

Peter Kafka - Re/code

Thanks.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Ted, I want to ask you a little bit about your relationship with your major suppliers. You I'm sure see the – or hear the rhetoric as we do growing out of Hollywood. Maybe start with Disney. How is that relationship today? They've obviously come under some pressure around ESPN and cord shaving. But is your relationship with Disney as strong as it's been? And should we expect that you may be able to expand your Marvel TV relationship in particular? I'd love to hear any sense for how Daredevil Season Two is performing and performed relative to the first season with that audience built.

Theodore A. Sarandos - Chief Content Officer

Sure, so I mean these have always been relatively complex relationships where you are both supplier and sometimes competitor. So in the case of Disney, they're a major supplier and they're a producing partner where they produce our Marvel Defenders series. We just kicked off our fifth season of production on the show. It's a very lucrative piece of business for Disney, obviously and a great partnership in that way. And there's no way to kind of isolate the two sets of businesses completely.

So while – they're a great producing partner, they're a great licensing supplier, and we're always trying to figure out ways that we don't bump into one another competitively, but sometimes, it's inevitable.

Daredevil Season Two was fantastic. The critics loved it. The viewing numbers have really grown. And we've added an enormous number of people to Daredevil Season One, both because of the excitement around Season Two and that we're in additional territories that didn't have the opportunity to see this show in the first go around. So it's been a real success and we're really excited to be in business with them. And all of our suppliers either produced for us or licensed to us and probably compete with us on some level, and we're just always trying to navigate those waters,

very similar to the way networks deal with one another and produce for one another.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And did the changes you're seeing out there impact the timing with which you may get to your 50/50 split of original spending and acquired? You throw out in the letter 5% of your spending I think today is on films. How would you fit film spending inside of that 50/50 mix long-term?

Theodore A. Sarandos - Chief Content Officer

Well, right now, we're trying to compliment our film selection between aggressively ramping up our global originals, which some of the people want to see everywhere in the world. Plus licensing, we're opportunistic. We've been doing pickups of films at film festivals, particularly ones that have broader commercial appeal, like next month, we've a film called The Fundamentals of Caring with Paul Rudd that I think fans are going to really love when we launch that around the world.

And then, regionally, we're also doing some opportunistic licensing. As you know, we pick up the Disney Pay One output later this year. And we also like – just in this quarter, we'll have the Minions. We'll have Goosebumps. We'll have Hotel Transylvania 2. And we'll have the film that won the Academy Award for Best Picture, Spotlight, exclusively on Netflix in the U.S. So it will be hard to comp against those kind of numbers as we're ramping up films because we still have a great selection of other films as well, but we're going to keep pushing it. There's no mandate or no initiative to how quickly we want to get there. And success, we just want to keep pushing it forward.

Wilmot Reed Hastings - Founder and CEO

And later this week we'll be releasing the first trailer for The Do-Over, Adam Sandler's next film for us.

Theodore A. Sarandos - Chief Content Officer

Right.

Wilmot Reed Hastings - Founder and CEO

And the trailer is incredible. I think you're going to find that this is a movie that really delivers for the Adam Sandler fans extended.

Theodore A. Sarandos - Chief Content Officer

That will be available globally as well in May.

Peter Kafka - Re/code

Reed, maybe, Ted, If I got on a plan, I can download some of Amazon's original – I guess all of Amazon's original content, some of their studio stuff they've licensed and take it with me for offline viewing, YouTube Red lets me do that. Why not offer that for some or all of your content?

Wilmot Reed Hastings - Founder and CEO

We should keep an open mind on this. We've been so focused on click-and-watch and the beauty and simplicity of streaming. But as we expand around the world, where we see an uneven set of networks, it's something we should keep an open mind about.

Peter Kafka - Re/code

And then this one is a little more future, off in the distance. But how long do you imagine before some combination of VR, AR, 360, any of the stuff you see people experimenting with on Facebook, YouTube becomes relevant to what you do?

Wilmot Reed Hastings - Founder and CEO

I think it's mostly going to be an intense gaming format for a couple years due to the price of the consoles. So think of it like the PlayStation 5 or the Xbox 2 or something. Its heritage to console gaming will be a lot of that market. And then everybody hopes that it matures into something that's lower cost and more ubiquitous. So I don't think it will have a direct effect on us in the next couple years because I think the center point for VR will be other sorts of things than watching a TV show in a VR headset. I don't think that will be very popular.

Peter Kafka - Re/code

Thanks.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

David, turning to some of the financials, you gave some color for the year around contribution losses internationally, I think looking for something around \$370 million for the year now, which is less than at least you had articulated and we had thought previously. What's driving that improvement? And it sounds like that's a focus for you as you head into next year. If you could, spend a little bit of time talking about what's moving the international losses lower and how that may trend into 2017.

David B. Wells - Chief Financial Officer

It's nothing more than growing revenue faster than your content spend. So I think it's just the fact that we've got multiple markets now that are improving year on year in terms of growth and economics, and you stack them together and you got a picture where collectively they're covering any of the new markets that we could have launched this year and then next year or the year after. Depending on the size of that market, they could be covering them all. I think we're giving ourselves a little bit of flexibility because the more of an opportunity we see, the more we may put back into the business in terms of additional investments and content.

But we feel like today that we can do all of that and still grow operating profit, which is why we can continue to make the statements about meaningful operating profit next year, but we feel like we can do both. So I don't think internally there isn't a different plan perhaps versus expectations. People felt like there might be higher losses internationally, but it's been fairly consistent I'd say over the last three to six months.

Wilmot Reed Hastings - Founder and CEO

And do you want to talk about the weakening of the dollar and how that affects us?

David B. Wells - Chief Financial Officer

Sure. So we did highlight this in the letter. And you live by the currency, die by the currency in terms of the fluctuations. Last year we had a lot of headwinds, especially on the international revenue line. We had to explain why our international average subscription price was flat in certain quarters when it still was growing. This year we're seeing the reverse of that with the weakening of the dollar at least in the first part of the year here where our international contribution margin is benefiting from that. So we did highlight that for you in the letter. Thanks for pointing that out.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And, David, as a follow-up, you're doing more and more global deals. Can you just remind us how you're allocating licensing costs and whether that's having an impact on the quarterly movements in margin? You guys guided to I think a sequential margin step down in the U.S. How much is the allocation issues or allocation thought process impacting those moves?

David B. Wells - Chief Financial Officer

Part of that, the U.S. P&L or the U.S. contribution margin, we've said this before, I'll reiterate it, is definitely benefiting from the fact that we're launching more in international markets. So the cost of that global original

that Ted talks about is being spread by more markets. There's some relief to the U.S. P&L.

And in terms of the allocation mechanism, it's really by media market value. In the early days, we were doing it by broadband households. That was overcharging certain markets where if you had a very knowledgeable, experienced media buyer in the market, they would say there's no way that anyone would pay for this particular title at this amount in the market. So we refined that to a media market value that's validated by some third-party market survey information. I would say in general, it's vetted by our own buying team internally as to what would be paid for that particular title in the market.

Wilmot Reed Hastings - Founder and CEO

And then margin being tight in Q2 is really related to the large amount of content and associated marketing for launching those content that we're very fortunate to have.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Thank you.

Peter Kafka - Re/code

You guys are moving people towards a \$10 a month price point in the U.S. For the folks who have the \$12 plan, what are they using that for? Are they using it to get high-def or are they using it for four streams. What's the usage pattern for those customers?

Wilmot Reed Hastings - Founder and CEO

Ultra high def 4K is becoming quite popular. We're the leading source of ultra high def content now. Ultra high def televisions are for sale at Best Buy and Costco. So we're seeing that ecosystem development. And then if you pay \$1,000 or \$2,000 for a 4K TV, it's pretty natural to bump your Netflix to the \$12 plan in the U.S. and about equal internationally to be able to get access to that 4K screens and see what your TV can really do.

Peter Kafka - Re/code

And so that's the majority of the people who are paying you \$12 are using it for the ultra high def?

Wilmot Reed Hastings - Founder and CEO

That's right. The video quality is really the big driver. And similarly, our standard def plan, which is DVD quality, is great for people, \$7.99, and so that's a really strong option too. So we're not trying to bias people. We're trying to help them make a choice that they feel great about and that they'll stay with. So think of us as really investing at both ends, the \$7.99, \$9.99, and \$11.99.

Peter Kafka - Re/code

You spell out in your letter that the price hikes that are coming this month, next month, that you'll be staggering them throughout the year. It's not all going to happen in one fell swoop. Is that a change in plan or was that always the direction you were going?

Wilmot Reed Hastings - Founder and CEO

That's always what we thought. It's a little bit cautious, but it won't hurt. We don't particularly need the revenue in the short term, so it's fine to just spread it out.

Peter Kafka - Re/code

Thanks.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

David, just coming back, a couple more on the numbers. The contractual obligations were up to I think \$12.3 billion at the end of the quarter, which was a bit of a jump from the end of last year. Is that the Disney Pay One deal kicking in, or any other color you'd add as to why that number inflated a bit?

David B. Wells - Chief Financial Officer

It's really the Netflix global launch. So you got to think about it as we're adding more content now for the rest of the world. It's our newer markets as we add more content, those markets are growing in content spend more quickly than some of our more established markets. So you combine those and I think what you'll find is if you take that obligations number over our average membership for the quarter, it's still in that band of about \$150, \$160, and it really has only popped up this quarter because of that new launch, basically, of Netflix global.

Wilmot Reed Hastings - Founder and CEO

And remember, on Disney we have Pay One today in Canada and then we'll be adding it this fall in the U.S.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Right. And just on the cash flow outlook, should we still be thinking about \$1 billion burn this year and any color for next year, and when might Netflix generate substantial free cash flow?

David B. Wells - Chief Financial Officer

So no change on the outlook on either this year or next year. I would say \$1 billion is a pretty good guide for both this year and next year. And really, on free cash flow positive, it really depends on the size of the business. It depends on how much more we'll continue to grow the content, which does depend on the size of the business. So in that way, I will turn the question around and say, how big will we be? And then I'll tell you when we'll be free cash flow positive.

Wilmot Reed Hastings - Founder and CEO

It's how big we'll be, and then how crazy does Ted go on these productions. And what we found is that these really big productions, like The Crown are just terrific for us in global brand building. And so, we're very excited about being able to deploy the cash to create shows like that and like The Get Down that's coming this fall also.

Theodore A. Sarandos - Chief Content Officer

Yeah, you should kind of think about it, though, that those big productions play a much more like a big blockbuster film in the fact that not only do they get more watching in the US, but they travel much better too. So you see in all these non-English speaking territories, these series perform very well.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Well, Reed, I was going to ask you, because I think you were quoted in The Guardian talking about or predicting spectacular budgets for TV series. Are your comments just now reflecting that expectation, and does that suggest any reduction in the return on spending that Ted's doing?

Wilmot Reed Hastings - Founder and CEO

No, I'd suggest an increase in return on spending if anything. That is when you spend on the big items, they go much, much further than a whole lot of substitutable content. So we're interested in both spectacular content and spectacular membership growth.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Good answer.

David B. Wells - Chief Financial Officer

And what we've found is that people globally love high production quality content.

Theodore A. Sarandos - Chief Content Officer

It's why U.S. content has traveled the world historically so well because of the production value that you're seeing. So when you see things like, next month, we'll have our fourth season of Orange Is the New Black, that was kind of a surprise to most people in that it didn't have any of the established movie star talent that some of our other shows have. But it had built up just on the quality of Jenji's storytelling. And then the spectacular cast and the ability to get to know them better, and then, as we enter its fourth season now, it's got tens of millions of fans around the world that can't wait for that show.

Sometimes you can get that built-in excitement with somebody who brings their own draw and their own star power, like a Will Smith movie or a Brad Pitt movie that comes out, or Naomi Watts starring in a TV series for Netflix, or Drew Barrymore starring in a TV series for Netflix. This is a way that people can more quickly get to know some of our newer IP.

Wilmot Reed Hastings - Founder and CEO

And Orange is only 60 days away, June 17.

Theodore A. Sarandos - Chief Content Officer

June 17.

Peter Kafka - Re/code

Does that bigger better super-size it attitude, is that going to apply to feature films that you'd like to release theatrically? Could you do a Star Wars-sized production? Or does the push back from the traditional cinema distributors prevent you from really going whole hog on a movie like that?

Theodore A. Sarandos - Chief Content Officer

You should look at our original films as similar to a slate of studio films. And that's Fox did have Star Wars distributors, they also had Brooklyn. And they had a lot of things in between. And that's what we're looking at too.

Whether or not a movie at the Star Wars level makes sense yet, we'll see, but we're ramping up. You saw recently that we announced that we're doing the next Will Smith movie called Bright, with David Ayer directing, which is a big budget summer movie. In fact, it will be David and Will as soon as they've come up of Suicide Squad. That's their next film. And it will premiere on Netflix in 2017, included in your subscription costs. So while we're all debating around big ticket day and date pay-per-view, we will be debuting that movie on Netflix included in your subscription cost all over the world.

Peter Kafka - Re/code

But you're not going to the tent pole strategy that big studios have gone to yet, where you're doing a handful of very, very large productions. You want a range of them?

Theodore A. Sarandos - Chief Content Officer

A range of productions. Correct.

Wilmot Reed Hastings - Founder and CEO

That's right.

Peter Kafka - Re/code

And then you mentioned the day and date debate. I mean you've seen the directors come out and say we like the idea of playing with the window. What's it called? What am I thinking of? The Screening Room product. Does that mean anything to you? Is that something you guys could participate in?

Theodore A. Sarandos - Chief Content Officer

No, like I said, we wouldn't mind having our films available on that product to the extent that people want to see it. Our focus is on movie lovers and movie fans, and trying to get them the content that they want at reasonable prices in great windows. So for us, being able to produce our own films gives us more control over those windows and the quality of the films themselves. So Screening Room to me would be a great way to get content in front of consumers if they're willing to pay for it.

Peter Kafka - Re/code

Thanks.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Reed, you've talked historically about a 60 million to 90 million subscriber opportunity in the U.S. And I'm just wondering as you sit here today, if you can update us on your expectations long term in the U.S. market. Is there anything that you think needs to happen that isn't happening today to get you there? For example, whether MVPD set-top broad distribution in the U.S. from, say, a new Charter or Comcast would really help accelerate the growth in the United States?

Wilmot Reed Hastings - Founder and CEO

It helps a little bit. We are integrated with Suddenlink in the U.S., which is about 1 million subscribers. And of course, in Europe we're integrated in many platforms. But think of it as the fundamental draw of Internet TV. You can get it on a Smart TV, you can get it on an Apple TV. So there's a lot of ways around it where we don't have that distribution on cable. But it's one more platform, and all platforms are good. It's not something we need to say get to 60 million to 90 million subscribers. And we're continuing to see just that steady growth. To have 2.25 million net additions in the U.S. in Q1, basically the same as the prior two years, it just felt great. So we're really excited about what the new content as it builds is able to do for us.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And, Ted, one of the things we hear from particularly investors in Europe is just that there's a limit to how far U.S. exports can get you. I don't know whether you agree or disagree with that, but I'm just wondering if you think, particularly in markets like Europe and France who might have let's say unique content tastes, that you need to go more local with your spending in those markets than maybe some of the early international markets, for example.

Theodore A. Sarandos - Chief Content Officer

I do think that what's popular in a market is much more a reflection on what's been available to that market over long periods of time. So what we've been really encouraged by is just how international our original series have been. So you take non-English speaking territory, you spoke about Brazil earlier, and not only is it non-English speaking, it's a non-Spanish speaking Latin American territory. And in the last 30 days, eight of the top 10 most watched things in Brazil have been Netflix original series. So these shows play very well, throughout Europe as well.

Now that being said, we think it's worth it to complement the selection by focusing on some local productions in those territories throughout Europe and throughout Latin America. So where Reed had mentioned, but on May 5, we'll launch Marseilles, which is our first French language show filmed in

France, starring Gérard Depardieu. We're also filming original series in Spain, in Brazil, in Italy. So we are definitely investing in local language content, particularly in those markets that have shown some desire for more local programming, but as a complement to our global offering.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

And, David, does that mean by default those markets may be lower margin than the U.S. market long term?

David B. Wells - Chief Financial Officer

No, I don't think that's what Ted's saying. I don't think you can equate the two. Even when we're looking for a local original like Marseilles, we're considering the economics of that production based on the total French diaspora, so not just people in France, but people outside of France that are interested in French language content. So I don't think you can – you can't necessarily equate those two. And we preference the content when we're developing those local originals for things that have potential demand outside of the original market that it's produced in.

Wilmot Reed Hastings - Founder and CEO

And our Japanese original, Hibana, for example, we're launching this quarter. And that will be available globally, so think of all that content where we're developing it locally, distributing it globally, and connecting the world through that. And we think that's a very powerful formulation that will help us grow for many years ahead.

Theodore A. Sarandos - Chief Content Officer

The Marseilles example, Gérard Depardieu is the biggest star in France and one of the biggest stars in the world. And we have about 2 million people in the U.S. who watch French language television regularly on Netflix. So that's where we're talking about the scale that we could bring to a production like that for France and Europe, but really for the world.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Thank you.

Peter Kafka - Re/code

Ted, what's your biggest non-English speaking audience in the U.S.? You said France is 2 million – French is 2 million.

Wilmot Reed Hastings - Founder and CEO

Probably Hispanic.

Theodore A. Sarandos - Chief Content Officer

Probably Hispanic. I would imagine it would be Hispanic.

Peter Kafka - Re/code

Makes sense. Reed, were you surprised that HBO said they had about 800,000 subs after about six months going head to head with you as a standalone product?

Wilmot Reed Hastings - Founder and CEO

A little bit, I think it's a great product. I use it all the time, but then I think for many other people, they probably just subscribe to HBO on cable and they're used to that.

Peter Kafka - Re/code

So you thought the number would be higher than 800,000 subs?

Wilmot Reed Hastings - Founder and CEO

Yeah, just because I find it – the thing I like about HBO NOW is it's just easier to use. You can use it on the mobile. You can use it on many different Internet platforms, but then I'm pretty Internet-centric. So I may not be – apparently I'm not as typical of the audience, but they're continuing to do great work. And what that does is just reinforce to the consumers how great this new Internet thing is for TV. And it just sets the drum beat. So I hope they continue to have more and more success.

Peter Kafka - Re/code

Ted, there's more money coming into the market for programming, HBO, Showtime, Starz, you guys, Amazon. Crackle is getting into it. Verizon is spending a lot of money. CBS All Access, I've got a list. And that's just in the U.S. Does that number continue to get bigger in perpetuity, or does it retract at some point? People say all right, we've overdone it, we're going to pull back on this matter.

Wilmot Reed Hastings - Founder and CEO

It's hard to tell. People talk about the growing content spend. But what we're able to do is find the shows and get the shows that we want, and we do have to pay a lot for them. But coming back to the phrase earlier, they're really spectacular, what we're doing. And I think when you see Orange,

when you see The Get Down, when you see The Crown, you'll know why we're investing what we do.

Peter Kafka - Re/code

Thanks.

Theodore A. Sarandos - Chief Content Officer

Peter, I think it's a debate around how to best monetize your content. And if you believe you can, over the long haul, best monetize your content with your own app, then you'll go that path. If you believe you can best monetize it by licensing it to Netflix, go that path.

Peter Kafka - Re/code

Thanks.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

What's been the feedback initially from members around your price points in the rest of world markets you launched in January? Obviously, relatively expensive versus existing sort of Pay TV or entertainment options, any thought about changing your sort of global price point approach in those markets?

Wilmot Reed Hastings - Founder and CEO

We really haven't seen price be much of an issue. But then today, we're serving English language speaking elites around in these countries. So in the model of what we're doing, in targeting the high end, the price is fine. We'll see over the coming years and we expand, and we may need some flexibility eventually, but nothing in the short term. Why don't we do the last two questions here?

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

I was just going to quickly follow up on that topic, and I'll hand it back to Peter for the last one. David, you guys are working on more local language offerings, better payment processes, other kind of operational improvements in those rest of world markets. What's the timing there? Should we be thinking about that through the remainder of this year, or is it a longer term timeframe?

David B. Wells - Chief Financial Officer

It's both. So you'll see some this year, but really it's about the next two years to three years in terms of improvement. We've only just started skimming these markets. So we'll be looking at them opportunity by opportunity, and you'll see some this year, but you'll see some continued into next year and even into 2018 I think. But we have a big opportunity in front of us, as Reed pointed out. Many of our Internet peers have a dramatically larger business outside of the U.S. versus inside the U.S. So we're pretty excited about that opportunity.

Theodore A. Sarandos - Chief Content Officer

And I think one of the really exciting parts about being in all these countries is being able to discover the next great storyteller for the world. So because we're more focused thinking about India where we weren't thinking about that at all a couple of years ago, we acquired this great film at Braham Naman at Sundance this year that we will be premiering around the world in June, and it really is a discovery of a great Indian director named Q who I think everyone is going to be talking about over the next few years and having that kind of global sensibility increasingly is going to help programming for everybody, not just the subscribers in those countries.

Wilmot Reed Hastings - Founder and CEO

And so in a movie like Braham Naman, it's an English show, it's accessible to many people. But YouTube has over 50 languages, we only have about 20. So that scales for you roughly how far we've got to go.

Benjamin Daniel Swinburne - Morgan Stanley & Co. LLC

Thank you.

Peter Kafka - Re/code

You guys are moving into more and more kids' content. Does it make sense for you eventually own the IP yourself, instead of licensing it through Disney or Dreamworks so you can create ancillary revenue streams?

Theodore A. Sarandos - Chief Content Officer

We do a lot of both. The consumer products addition to those projects relative to the content value itself is pretty small. We can look to optimize that stuff down the road. In Q2, we're launching nine seasons of original kids' content, including a new season of All Hail King Julien, which is nominated for a Daytime Emmy. This year, we have 33 Daytime Emmy nominations for our kids' content across seven of our different shows. So

we're really focused on building up the quality of that programming that's exclusive and original to Netflix.

Peter Kafka - Re/code

Do you see a Ted Sarandos Land or a Reed Hastings Land at some point?

Wilmot Reed Hastings - Founder and CEO

We were going to nominate as Kafka Land.

Wilmot Reed Hastings - Founder and CEO

So to wrap up here, I want to thank Peter Kafka who's been with us these last few calls and is retiring from this side job. And thank you for your involvement in this. And to all the investors, thank you for your support. We had just a great quarter with 6.5 million net adds over 81 million subscribers. We cannot wait to breakthrough 100 million subscribers sometime next year. It's going to be a big celebration. We're looking forward to it. So thank you very much.