Welcome to the Q1 2015 Netflix earnings call. I am David Wells, CFO. Today, I will be joined on the company side by Reed Hastings, our CEO and Ted Sarandos, our Chief Content Officer. Interviewing us will be Mark Mahaney from RBC and Michael Nathanson from MoffettNathanson.

I think Mark has the first questions. So over to you Mark.

Question-and-Answer Session

Q -Mark Mahaney

Okay. Thanks, David. First question is for Reed. This was maybe an inflection point quarter in terms of the domestic streaming sub adds. They came in materially ahead of your guidance. They were actually up a little bit year-over-year, which is a bit of a surprise. In the press release you talked about both getting more subs in and retaining them better, maybe than you had expected. Could you provide a little bit more color? And is this something that you think is happening across the industry, the greater focus on streaming offerings is just helping the leader in the market? Or is there something specific that you are doing on both of those ends, the gross sub adds and the churn?

Reed Hastings

We have continued the focus on the same things over the last couple of years, improving the content, improving the streaming, improving the user interface. And we have seen the rewards of that in continued growth. I think this quarter in particular, we had some amazing original content with Unbreakable Kimmy Schmidt, with House of Cards, with Bloodline. And so all of that compounded to really push us forward and certainly what you are seeing is all of Internet TV growing. The attention of the new launches of the competitors is only creating a bigger ecosystem, drawing more and more people into thinking, hey I have got a check that out and try this Internet TV thing.

Mark Mahaney

And Reed, for some time you have talked about a long-term goal of 60 to 90 million subs. At this pace, sooner or later the financial markets might actually agree with you. Any updated thinking on where we could fall in that range and when we could get to that?

Reed Hastings

Well, I would say they agree with us already. I mean at a $25 billion to $30 billion market cap, there is a lot of growth pressed into it, I think you would agree. And so yes, 60 to 90 million feels great for us. We are continuing to grow. That's the 60 to 90 million in the U.S. market. Of course, the really big upside beyond that is in international. For most global Internet firms, the U.S. is 20% to 35% of usage and revenue. We are not anywhere close to that yet, but we are continuing to invest in international.

Michael Nathanson

Reed in the past quarter, we have seen new entrants like HBO NOW and Sony Vue come out with pricing, it looks pretty expensive relative to Netflix. I wonder, do you think you have a pricing umbrella, given where they have launched their products relative to where you guys have price today?

Reed Hastings

Well, no. I think HBO at $15 is a great value. I mean I have traditionally paid more than $15 for my cable company for it. So I think they are doing great work with their premium content. It does create obvious underline of just how great the value is of Netflix with prices ranging from $7.99 to $11.99. But we are really comfortable with that strategy. We are continuing to grow with this strategy and it is an incredible value. But I think we you should really think about it is all the Internet services HBO Now, Netflix and Hulu are great values in comparison to the big bundle.

Michael Nathanson

Okay. And David for the current quarter, you talk about the trend on churn. I know you guys don't give out churn numbers, but what was the impact of original content on churn this year versus a year ago?

David Wells

Well, as Reed said, just picking up on those comments, you really do see the improvements in the service, both on the content, the interface, the payments across the globe really move together. So you see that with acquisition and churn improving, but we did see improving churn. So we are saying that we saw improving retention through the quarter and that contributed to that net add performance and growth that we saw in Q1.

Mark Mahaney

Great. And David, if I could stick on the U.S. business, last quarter you talked about 30%-ish margins, 90 days later we are already materially above that and you are telling people to expect your business to be above that. So just, I know there are some stuff in the press release on it, but any more color on why there is such a pretty material shift in the margins and to what extent should we just be concerned that you are just pushing content cost in international markets, so really there is not an improvement in the leverage here in the U.S. business?

David Wells

Well, it's both, Mark. So there is absolutely an improvement driven by the growth. We are growing revenue faster than we are growing our expenses. But in terms of the outperformance relative to our target of where we would want to be in terms of U.S. margin growth, it's a couple of the things that we have talked about in the letter. One of them is, we are shifting marketing from the U.S. to international. We think we can grow a little bit faster on international. It's more efficient to do that.

And the second thing is a little bit of just the mechanics of how we allocate content cost by geography. So by growing faster internationally and putting that allocation more towards international, it's going to provide some relief to those global originals in the global projects that we do have that are allocated to the U.S. and we intend to continue to invest in that. That's also why we put in the letter that our target remains the same, 40% in 2020.

So we want to continue to balance the growth of profit with the growth and the competitiveness of our service. We want to reinvest in the service prudently along the way.

Mark Mahaney

So let me ask a two part follow-on question to that, one for David and one for Ted. David, coming back, marketing spend in the U.S. in an increasingly competitive market, some level that feels a little extra risky than you should be doing. So can you just talk through why you are so confident you don't need, you can cut back on those marketing dollars in the U.S. beyond just one quarter of better-than-expected results?

And then Ted, last quarter in the letter, there was this bolded section, therefore it caught my eye, about content spend being more efficient with original content than with licensed content. Do you feel like you have really reached a point that that's what we are seeing in the business model today that you are continuing to see more leverage just with that original content purchase?

Ted Sarandos

Yes. I will take the last question first there. What we are seeing is the dollars invested in our original programming are more efficient, in that for every dollar spent, we get more bang for the buck in terms of hours viewed. And hours viewed leads to higher retention, more word-of-mouth and more brand halo. So that why we say that it turned out to be not just an important strategic investment but also an efficient one.

David Wells

And Mark, on your first question about our relative comfort with moving dollars out of the U.S. and in to international, which is one quarter. I would say we have had multiple quarters of strong growth. Marketing dollars have been up, they have been down. I don't think there is a direct connection within one quarter in terms of the level of marketing spend and the level of growth that we see. We have migrated over the last two to three years to be more content forward in our marketing, more digital in our marketing. We are getting smarter and more efficient about how we put those dollars to use. And so right now we think there is a greater opportunity with international and that's what we are doing, we are moving to international spending.

Michael Nathanson

Ted, in the past six months, we have seen Viacom and Turner write down the value of acquired syndicated content. Truly the value of the content wasn't worth what they were paying. Can you talk a bit about your own usage trends on acquired content? And whether or not you think the long-term trend for what you are acquiring will be declining on a per hour basis?

Ted Sarandos

Look, as we continue to grow, the thing that's most encouraging is that the content we are licensing around the world has got equal and sometimes even disproportionate value to us outside of the U.S. So what we are seeing real global value from licensing shows in multiple territories. And as we are continuing to grow domestically, we are seeing those viewing hours on licensed content, even older licensed content as we saw with Friends last quarter where the viewing continues to grow. So we are still seeing a lot of value from that programming, both our original and our licensed programming from all those sources.

Michael Nathanson

And you expect the price paid going forward will be trending up or down for the acquired?

Ted Sarandos

It's tough to say. Mostly it's a reflection of how many buyers are in the market. So we have got a few other people into the market, there is some value in having a larger footprint and being able to bring more value to the franchise, what for being on Netflix that we get to realize in our negotiations. But I think most of those prices, up and down, is driven by the number of competitive buyers in the marketplace.

Michael Nathanson

Okay. Then let me ask one more for David. You mentioned before on the content spend shift between U.S. and international. Can you remind us again how you amortized content between domestic and international markets? How do you decide what the allocation rates are between the two geographies?

David Wells

Sure, Michael. In terms of how we amortize is straight line for originals, there is accelerated. How we allocate across countries or territories between the operating segment of domestic and international is based on the relative value of that content. So we use the PwC media survey to help validate what that content would be worth in that market. And there's pluses and minuses to various types of allocation. We have looked at many types. So we think that's the most accurate in terms of ascribing the relative value of content within each market.

Reed Hastings

And David Wells, if we have a global content, where does the allocation for Poland show up today?

David Wells

Today, the allocation for Poland is going to be spread across because we haven't yet launched that market. So what's little bit new for us is we now have clear line of sight that we are launching the rest of the world, which is new relative to the last six to nine months. So we shifted a bit and you are seeing part of that Poland, if we sign a global right for Poland, distributed across our current territories. A year ago you would have seen us, if it was going to be launched in the next year park that on the balance sheet and then start amortizing it once we launched Poland. And if we prospectively signed up for a Poland right and we just didn't have line of sight to the next year whether we were going to launch the territory, that would be spread across the existing territories that we were in, which is what we would do today.

Ted Sarandos

If we back it up a few years, we would have sold off Poland, not knowing what to do with it and look for it later.

Reed Hastings

That's right.

Mark Mahaney

Okay. If I can get back to Reed on a question I came up really about pricing and maybe tearing power. So Reed, your latest thinking, given the momentum in the business and the ability to raise fees or raise ARPU over time and particularly via tearing either be it service and number of lines or content, your latest thoughts on your pricing and tearing power today?

Reed Hastings

Well, Mark, we are super happy right where we are. We have got a great mix of pricing plans and options and for those who get a new 4K television and they are excited about 4K content, we are the leading service in the world for 4K and that plan is a little more expensive at $11.99. So as more 4K TV is sold, we will get people to upgrade to the $11.99 plan.

In terms of the total pricing structure, we couldn't be happier with the way it creates an incredible value for the consumers. It feels fair to them and it's propelling our growth.

Mark Mahaney

Okay. Now let me pivot over to the international markets. So we also had subs upside in the U.S., we had subs upside internationally. Could you talk about where that came from? What wasn't mentioned in the letter was Germany and France, those are obviously major markets. Maybe they are growing in line or little less than you thought? What was mentioned is Australia, New Zealand. So any particular color there on which countries are performing in line, better and worse than expectations?

Reed Hastings

Sure. That's somewhat of a recency bias. We launched France and Germany six or eight months ago and we talked about it in the immediate aftermath also that they were successful launches. Now we have added Australia, New Zealand. And all of these markets, the Internet and Internet television is catching on and we are leading relative to competitors and we have got competitors all around the world. In each market, there is a series of competitors. So we are feeling very bullish on the long-term in all of these markets. We have seeing when we entered in Latin America three or four years ago that it takes us a year or two to build the brand and get awareness. But think of it as every country in the world are and consumers in every country in the world want the benefits of Internet television choice and selection and price. So absent severe piracy that might be in some of the newer countries, I think we are going to see large commercial success.

David Wells

And Mark, this is David. There was no one particular market that drove that. So there were multiple markets that drove that outperformance relative to what we thought to our forecast.

Michael Nathanson

And in Reed's tweet a couple days ago, you mentioned 10 billion hours consumed in the quarter. Could you us give a sense of consumption rates domestically and internationally? Are there any international markets that jump out to be above normal consumers?

Reed Hastings

There is variation between countries. Some countries are amazing. And U.S. is one of them. But it's not the biggest. So for competitive reasons, I am not going to give your precise color. But there is variations. And what's great about the viewing is if you look two years ago in this call, we said it was 4 billion hours in the Q1 and over those two years, we have gone from 4 billion to 10 billion hours of viewing. And so you can see along with our membership growth, we are also having engagement growth, which given all the new competitors, improving television, is really impressive that Netflix is growing not only the subs but engagement also.

Michael Nathanson

Okay. And then Ted, you recently mentioned that in China, it sounds like you have a go alone strategy. So what is your timing on China's launch and how does that strategy impact your actual launch in China?

Ted Sarandos

Well, Michael, a bit of that press was lost in translation a bit. I was explaining to the questioner why we have not taken up partners in the past. But it's not a reflection of whether we want to or what we are willing to do in China. We are anxious and open to all forms of doing business in China. So the press was a little bit out of context there.

Mark Mahaney

Okay. David last quarter in your script press release, you bolded one of those things was the expansion to all global market by the end of 2016. Is there an update on that given what's happened in the half of the year? Are you accelerating that timeline?

David Wells

There is no update other than the expectation for us to launch in 2016 was as an acceleration of our earlier stated objective. So no further update.

Mark Mahaney

And then for the June quarter, you talk about an increase in the operating loss to $101 million. You have got bigger launches in the back half of the year. Help us think about when the peak operating loss quarter is in international and what the size of that be? Could that be, if it's $100 million in the June quarter, what's the worst-case scenario? Are you willing to run it to $200 million loss in anyone quarter?

David Wells

Well, I don't provide specific guidance four or five quarters out for our operating loss. But we have said that we are committed to running the business at global breakeven and we have ambitious plans to launch international. So this quarter, what you have you see our guide with the full sort of Australia, New Zealand, you see our guide with additional investments in marketing and some content. We will have some bigger launches and we described as a meaningful and significant in the back half of this year. So you should expect those losses to trend upward and into 2016 and then to improve from there.

Michael Nathanson

Recently Reed, you changed your terms and conditions to alert people who use VPNs that they can be shut down from usage. We have heard a lot from our clients who are outside the U.S. as they do use VPNs to watch U.S. content. Why did you change the terms and conditions?

And for Ted, are studios asking you about VPN usage? Is that part of the reason?

Reed Hastings

So with VPN usage, that's where someone, to bring up Poland again where we are not yet operating, has the money to pay for content they want to access content, they want to pay for that content. Netflix is not yet in Poland. And so they will use the VPN to come to the U.S. virtually over the Internet, pay for content. So it's certainly less bad than piracy, it's not something we encourage. It's actually very hard to detect because VPN gets every good at covering their tracks for all the obvious reasons. And because we are focused on getting global very quickly, I think we will see this issue disappear and it will disappear because we will be able to meet the demand directly in all the countries.

Ted, anything on the studios as our partners?

Ted Sarandos

Yes. It's one of the many things that we have discussions with the studios about an ongoing basis and we do continue to work with them and work with these VPN. But to be honest with you, it's kind of a whack-a-mole to get ahead of the different usage of VPNs become kind a lifestyle thing for a very small segment of the population. The real great news is, in the piracy capitals of the world Netflix is winning. We are pushing down piracy in those markets by getting the access. So the best way to really make the VPN issue a completely nonissue is through global licensing that we are continuing to pursue with our partners.

David Wells

And Mark, to add to Ted, the only comments that I would add to Reed's earlier pricing comments were, piracy is a governor in terms of our price in high piracy markets outside the U.S. So we wouldn't want to come out with a high price because there is a lot of piracy. So we have to compete with that. So there is a little bit a governor on our price outside the U.S.

Michael Nathanson

Okay. And David, one question we get a lot of, that your content obligations they grew in this quarter. Can you talk a bit about your comfort of meeting those obligations? And when do you think you see a peak of your obligations on the balance sheet?

David Wells

Well, so I am comfortable with the level of content commitments we have. And there is a couple of reasons that I am comfortable with that, one is that the content is working. So we see engagement, we see value for the content. So it makes me more comfortable and confident that we are investing in something that has lasting value. Two is that we really are scaling along with the business. So we have grown from $9.5 billion in streaming content commitments in the table to $9.8 billion. That's about a 31% year-over-year growth rate and our streaming revenue has grown at 31% year-over-year as well. So that makes me a little bit more comfortable.

Now that includes what we know in terms of licensing commitments. It doesn't include things like Disney output. So let's take that as an example. That is for future film output at a future box office. So we are unable to know the licensing amount on those films, but we do have to factor that into our forecast as we have from the very beginning. So if we look ahead and we factor that in, we think it's an additional $3 billion to $5 billion of content commitments over the next three years and that's already baked into our forecast and we have been doing this from the very beginning. So we have got a little bit better at making sure that we waterfall deals, we have the flexibility we need to balance those commitments and that expense level over time.

Ted Sarandos

Michael, if I could interrupt for a second, I would also add that you should look at that as a signal of future access to content, because as we identify the high value content, we seek to lock them up in long-term deals. So that does increase our long-term obligation, but for things that we want and to attract revenue and viewing.

Mark Mahaney

Ted, could you stick on that topic on the content and especially the Disney output that's coming onboard next year, just to remind us of some of the details on that? And when you think about the white spaces of Netflix, the content areas that you would really like to most fill out, how important is Disney as part of those white spaces?

Ted Sarandos

Our Disney partnership is phenomenal. We have the output deal coming up that we just last week we launched our Defenders series for Marvel, with our first series Daredevil, it's been a huge success. Disney is the licensing partner with us around the planet. And we are really excited about the output deal coming on. It's probably one of the few output deals that I am enthusiastic about because the Disney content is global. It's tentpole. It's family. It's a lot of co-viewing among families for the content that gets watched. And it is a great brand to bring comfort to families who subscribe to Netflix. So it's a bit of a play between movies and kids programming that I think is successful for us.

The white space you refer to is, with all the excitement about the golden age of television and all the excitement about our own series, about a third of the viewing hours on Netflix today are still movies. So when we see something like we did early in the year with The Interview, we were able to close that window to 30 days, we had a phenomenal reaction in the U.S. and Canada for that movie. I want to keep pushing on behalf of consumers to get those windows narrower and narrower, including premiering original movies on Netflix which is why we are doing that to fill some of that white space.

Mark Mahaney

A two-part follow-on on that. Are there direct outputs from that Interview deal whereby you can actually do this much more often in the future? And then Reed, can I swing it back to you afterwards and ask you about products and major product pipelines in the next 24 months. I know you mentioned in the letter the enhancement of bringing video playback forward into the browse experience. I am not sure I actually understand what that means. Could you explain it? And then help us think about how material that can be to the user experience?

Ted Sarandos

I would say you should look at The Interview as a beautiful one-off. I say beautiful because bypassing the theaters and premiering on-demand, Sony managed to raise about $45 million in revenue from between a modest theatrical and primarily from digital on-demand and then a very strong fee for Netflix for the our license 30 days following that, what could have been a financial disaster and turned it into a financial win for the studio. So if anything you want to look at that and say, well, it's a beautiful possibility for future disruption in release patterns.

Reed Hastings

And as Ted said Mark, we are really sorry on the circumstances for Sony in the case of The Interview. We certainly wouldn't want to see more of that. But we are focused with our original new movies trying to push those windows up so early.

Then you asked about the product enhancements. We are doing so much. We tried to sample a little bit in the earnings letter. The particular improvement that we are talking about there written today when you browse for movies, it's a bunch of stills and then you say play, you wait a couple of seconds and then it plays the content. And what we are learning is how to use real-time video as you browse so that things are auto starting making that easier on the display pages, on the detail pages. So I think you will be really impressed.

But think of it as symbolic of a whole long series of hundred improvements per quarter that we are always working on in accumulation continue to make our experience better which pushes up the satisfaction, which helps retention to grow.

Michael Nathanson

Ted and Reed, when you first started building your streaming product, Ted would be in Beverly Hills giving people checks for content and all my content companies would say, this is incremental to the pie. We are happy that Netflix is a buyer. In the past nine months, we have seen ratings for cable and broadcast tumble to levels that I never thought was possible. So I wonder, do you worry that as our industry traditional media worries about ratings trends, they become less likely to sell you content and therefore it becomes harder to source really good second or original content? So I wonder how you feel about that?

Ted Sarandos

I am not seeing any actual evidence at the table in terms of that there is any reluctance to continue to sell. They are definitely trying to juggle the terms of their core business versus the license business, but that's true not just of us, but they are also seating these opportunities for themselves where you see the networks launching their own on-demand services. So I think they really are trying to find the right balance. And that generally I think we are still very healthy for the business in terms of both in terms of our licensing dollars and in terms of the audience generation that we are able to build for the shows on broadcast. And it's very encouraging that even with all of the disarray to you spoke about, that Fox can have a phenomenal cultural hit like Empire in the middle of all that. So I do think that there is obviously plenty of concern about the old way of doing business, but there is lots of action going into how do we do it going forward as well.

Reed Hastings

And you know, Michael, it is pretty naturally you have got to linear TV has been an amazing fifty-year run, Internet TV is starting to grow. Clearly over the next 20 years Internet TV is going to replace linear TV. And so I think everyone is scrambling to figure out how do they do great apps, how do they things like noggin are fantastic and that will just keep getting built up and so it's a transition into figuring out the Internet. And the way people do that is to get involved with us, with our competitors to try to start to learn what are the new patterns and modalities because Internet TV is the way that people will consume video in the future.

Michael Nathanson

Okay. And David, can you just talk a bit about your cash spend versus your P&L spend? I think this quarter was a 30% higher cash spend than P&L. Is that the right way to think about this year and even next year as well?

David Wells

Yes. Michael, we have been pretty consistently telling people that prior to the buildout of originals, it was 20% over the expense. Now it's drifting up to 30%. It could drift up to 40% and peak around there in certain quarters, especially if we take delivery of a lot of original product. But in general, we are building out our content investments, our original content investment and that is cash intensive as we put in the letter and we have been pretty consistent about this. I think what you are going to see now is several persistent quarters and going forward of negative free cash flow while we build this out.

Mark Mahaney

On that, David, you did this $1.5 billion debt offering in March quarter. Should the expectation on the market's part be that you won't need to come back to the markets for the next year-and-a-half? Or do you want to have the flexibility to, if international launches really do even better than you think, to come back for even more?

David Wells

Well, if we are successful in building out the content and if we want to get to ever-increasing mix of original content, meaning that up to 50% of our business is really our own owned content, then we are going to continue to invest in that content and that will require more and more cash. So I don't think we are saying no, that we are good now for the future. I don't think we are saying we are definite. But likely we will need, if we are successful to go back to the market at some point to continue to build that investment.

Mark Mahaney

And I want to ask a net neutrality regulatory question to Reed. This actually came from Rich Greenfield. With the FCC laying out this clear oversight of interconnection in that newly filed net neutrality order, do you think if that had been around before, that Netflix would have had to pay for the interconnections? If those rules had been in place, would they have had to pay for interconnections as they have been for whatever the last year or so?

Reed Hastings

It is awfully hard to tell going forward as we think about interconnection. It's a new climate with the FCC Title II in place and we will try to figure that out. We have a number of contracts that are in place already. So there is no immediate actions. But we are very encouraged by the general consumer perspective and political perspective that broadband access is so important that it is a utility. It is like power distribution where it's a natural monopoly in the last mile. There should be one fiber or one cable going to a home with super high speed and that's the architecture of the future. So everything around it being a utility is great for Internet companies like ourselves and it's great for consumers.

Michael Nathanson

Reed and Ted, in the past couple of weeks we have seen the NFL of all people explore Internet TV when they are announcing they are going to stream the game over the Internet. We have asked you in the past, but given the changes in the model, do you think you can add sports as a category to Netflix at this point?

Ted Sarandos

Michael, I think the part of our core consumer proposition is on-demand. We make viewing certain kinds of content better because they are on-demand. I don't know that on-demand sports is remarkably better than live sports. So that's why we haven't been that excited about why we haven't chased it. There is economic reasons as well. But I think in general that sports is great for live television.

Reed Hastings

And the great thing, Michael, about the emergence of sports online, is it frees people up to be more à la carte which gives us more money to be able to spend on Netflix. So if we can anchor the entertainment side for movies and TV shows for every consumer and somebody else or other set of leagues anchor the sports part, which is still over the Internet, then the Internet TV proposition is even more powerful for consumers.

Michael Nathanson

Okay. Over the past year, we have asked you about the Comcast-Time Warner Cable merger. You said, we would love to see deal conditions put on that in order to protect the Internet. You have gone above and beyond with the FCC Title II support. But one of the questions we have at our firm is price regulation Title II. So where do you come down on the FCC's ability to regulate pricing? Is that a good or a bad thing for the development of Internet TV?

Reed Hastings

I will have to say, it's very clear that broadband is a necessary utility across the land. I don't think anyone is a fan of price controls. So our main goal at this point is to get the government to block the Comcast-Time Warner merger. We think, were that merger to come together and as DSL fades, that company combined would have over 50% of U.S. residential Internet homes. And frankly that's just too much in one company.

Mark Mahaney

I wanted to ask a question on marketing to either David or Reed. You talked about maybe shifting more of your marketing budget online. Any more color beyond that? There is a lot of different places and ways to spend money online including via Facebook, et cetera. So any more color on that? And then why the switch to online? Is there something that's made the offline marketing channels less efficient for you?

David Wells

Well, it depends on the market, Mark. So in places where our brand is really well-known, we have noted that we are much more efficient being very targeted with that and being very specific around content marketing. Outside the U.S. in markets where we are building a brand, you should see a mixture of that. So you should see some offline and some online in terms of our spend. But every year we get more efficient and more knowledgeable about where that money is best spent. So we are an experimental company. You know that. You followed us. So you should see us continue to test around the edges of where things are better spent.

Mark Mahaney

Okay. And then a question on the actual end usage of Netflix, so maybe a broad question for Reed. When you think about the different use cases in the living room TV, on the go with mobile devices, et cetera, have you seen over the last two or three years a dramatic shift in how people are consuming Netflix content? And particularly as you go into international markets, which may be more mobile-oriented, particularly in Asia, are you set up the way that you want to be set up on devices in the formats to work that mobile trend?

Reed Hastings

We are feeling really good about our preparation for continuing to expand around the world over the next two years in terms of devices, in terms of networks, in terms of content. So yes, we have fought through a lot and studied the patterns of consumption and we are ready to at least begin that journey by launching around the world. And then what we will be able to do is learn from there, frankly as we did in Latin America three or four years ago.

Michael Nathanson

Reed, following on that question, has there been a handoff on tablets versus smart TVs? A couple of years ago we kept thinking smart TVs will be the device that drives Internet TV, but have you seen a difference on consumption by tablets versus smart TVs, the past couple of years?

Reed Hastings

Now we have seen smart TVs just continuing to grow and grow in usage and sales. Virtually every new TV sold now is a smart TV, at least at the middle and high-end and it's natural for people to use. Now, do they also watch on tablets? Yes and on phones. So really all those categories are experiencing absolute hours growth, but on a percentage basis, smart TV is one of our fastest-growing categories.

Michael Nathanson

Okay. And David, you called out the impact of foreign exchange in the first quarter. Could you give us a sense as to what the year is going to be on foreign-exchange? And then when do you expect to break out revenues by region so we can get more details on the regional and international?

David Wells

Well, if I knew what was going to happen with foreign-exchange, I would probably quit and then run a hedge fund.

Michael Nathanson

No, but what about for today. As of today? Okay.

David Wells

I would say, in Q1, most of that below the operating income foreign translation loss was unrealized, right. So we did have a change in our functional currency for our European entity. So when we first launched into

Europe, we were very U.K. centric. So most of our operating cash flows were in British Pounds, which leads you to an accounting decision to a functional currency accounts. Since we have expanded in Europe and particularly into mainland Europe with more and more of our operating cash flow switched to the Euros, we switched it over. So there is some impact of that in that translation adjustment.

Going forward, it really does depend on what happens in terms of the Dollar strengthening further into the Euro. We are about 25% in terms of revenues exposed to foreign currency and that's growing. If we are successful, that will grow to 50%, but we also are pretty transparent that we don't hedge. And so we are not really concerned with those accounting translation adjustments.

We are pretty transparent to you as an investor that we don't hedge. You have the option to go out and hedge if you feel like you are exposed with your Netflix investment and we are watching in terms of our opportunities for natural hedging, but with the move to a global license, we may see more and more of those be dollar-denominated. So I will have to update you along the way in terms of our foreign currency exposure.

Reed Hastings

And why don't we hit it with one more question each guys and then we will wrap up.

Mark Mahaney

Okay. Let me, David, just check off real quickly, ARPU in both international and in the U.S. market, in international markets assuming currencies stay where they are, does ARPU stabilize where you guided to implicitly in Q2 and where it came out in Q1 and then start moving back up as price increases go into effect? Or should we just straight line it? And then in the U.S., ARPU has been rising. Is any of that caused by tiering of services? Are you getting a lot more people signing up for the $11.99 plans? Or is that just the impact of the price increases?

David Wells

It's both, Mark. So just to answer your question, on both domestic and international we are seeing ARPU progression because of people taking the higher tiers and the higher value plans and we are also seeing the expiration of people sort of coming off, grandfather rejoining or joining the service new at the higher price point. And obviously, we have a lot more subscribers in the U.S. So you are seeing that ARPU increase disproportionately rise internationally versus the U.S. just because we are building from a base of much fewer grandfathered subscribers outside the U.S. So you see both.

But your very first question was, should we see that progress? Yes, but we have a large body of U.S. subscribers that come off grandfather next year. So you can waterfall your churn models and you would expect that the U.S. has a much larger base of folks at the older price point.

Michael Nathanson

Reed, over the past 10 years, you guys have a pivoted perfectly from selling DVDs, to streaming, to making old content, to going overseas. So I wonder when you look at your business plan, what gives you worry? When you look at the challenges ahead, what's the thing that worries you?

Reed Hastings

Well, you are nice to say we pivoted perfectly, but I think you are forgetting about certain incidents four years ago. But we have succeeded in getting through them and the key thing is that the company is very agile. We are just a learning machine. When you think about how Ted has grown our original content muscle is just so impressive. How are continuing to expand to international, it's just like were learning country by country. We don't get everything right upfront, but we fix that. So I think the fundamental is, we are just open-minded, curious, we are learning and then frankly it's that Internet TV is growing around the world at incredible rates. And so were really propelled by that big macro trend.

And to wrap up here, Ted's producing so much content. I though Ted, maybe you could share a little bit of this quarter's highlights like Chef's Table, Sense8 and Orange is the New Black and just the amazing things that Netflix is debuting.

Ted Sarandos

Well, you definitely get a sense of the diversity of the programming that we are going to be offering up, just if you look at just what's coming up next quarter with our first original documentary series called Chef's Table from the director of Jiro Dreams of Sushi. We have got a third season of Orange is the New Black which is a global sensation that will break in June, of our comedy with Lily Tomlin and Jane Fonda called Grace and Frankie that we are really excited to show to the world. Sense8, I think will show everybody what global TV series can really be like, filmed on location in nine cities around the world, spectacular scale and scope of a theatrical film, directed and created by Wachowski siblings and even original series for kids with How to Train Your Dragon 2. So we are super excited about both the volume and the quality and the diversity of everything we are doing in our original programming next quarter.

Reed Hastings

And Ted, are those series is globally available on Netflix?

Ted Sarandos

Globally available on Netflix in 4K.