Good day, ladies and gentlemen, and thank you for standing by, and welcome to the Netflix Fourth Quarter 2012 Earnings Q&A Session. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. (Operator Instructions) As a reminder, today's conference may be recorded.

It's now my pleasure to turn the call over to Ellie Mertz, Vice President of Finance and Investor Relations. Please go ahead.

Ellie Mertz

Thank you, and good afternoon. Welcome to the Netflix Fourth Quarter 2012 Earnings Q&A Session. I'm joined here by Reed Hastings, CEO and David Wells, CFO. We announced our financial results for the fourth quarter at approximately 1:00 p.m. Pacific Time today. The shareholder letter and the Q4 financial results and the webcast of this Q&A session are all available at the Company's Investor Relations website at ir.netflix.com.

As is our standard practice, we will begin the call with questions received via e-mail. Please e-mail your questions to ir@netflix.com. After e-mail Q&A, we will also open up the phone lines for additional questions not covered by the e-mail Q&A or the investor letter. The dial-in number is in our investor letter, but let me repeat it now. Please call 760-666-3613 if you would like to get in the queue. We may make forward-looking statements during this call regarding the Company's future performance.

Actual results may differ materially from these statements due to risks and uncertainties related to the business. A detailed discussion of such risks and uncertainties is contained in our filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed with the Commission on February 10, 2012. A rebroadcast of this Q&A session will be available at the Netflix website after 6:00 p.m. Pacific Time today.

Now, let's move directly to questions.

Question-and-Answer Session

Ellie Mertz

As is our standard practice, we've organized the questions by topics as we've received them this afternoon via e-mail. First topic, questions on the domestic streaming. To what extent would you attribute the growth in subscribers to mobile, particularly tablet adoption? How much of usage is over mobile devices, same question for connected television.

Reed Hastings

Both the rise of tablets and phones and the rise of smart TVs are very helpful to us and they are really the beginning of a trend around Internet-connected ecosystems with devices. And certainly, the more convenient those devices get, the more people will be comfortable watching and enjoying content on a wide range of devices, someday including Google glasses, Internet watches all kinds of scenarios over the next five years and as well as a multi-screen scenarios where you use your tablets or phone to choose content on your TV. So, what we will see over the next couple of years, and we saw in this fall also was more and more consumer adoption of Internet-connected streamings which on both tablets and smart TVs.

Ellie Mertz

What is the percentage likelihood that you increase the price of your streaming plan over the next 12 months or even over the next 24 months?

Reed Hastings

We are happy with $7.99 and not speculating on the future.

Ellie Mertz

You've talked about improvements in both voluntary and involuntary retentions. can you give us some color on where churn levels are relative to historical numbers? Are you back to pre-fall 2011 levels?

Reed Hastings

That is a really different business when it includes DVDs. Some, I'm not going to focus on that comparative reference, but what we are doing is seeing nice improvements, and again relative over this last year when we've been on the straight streaming side. And we'll continue to look at that. The fundamental though is not to focus or we don't focus on churn, because we really want to make it easy to quit. I know that sounds strange, but we spend a lot of time so that if you leave, you'll have a really good experience, and that makes you much more likely to come back in. And we think that's the right way to build a long-term growth in paid ads but it does result in easy access.

David Wells

And I would say that regionally it continues to be a very strong channel for acquisition and that continues to be the case. We've seen that in Q3, Q4, all the way through the quarter, and as a function of that, people flowing in and out of the service, and because we make it easy, they don't feel trapped by a contract and it’s really easy for them to come back into the service when their lifestyle warrants signing up again.

Ellie Mertz

How much confidence do you usually have at this point, going into Q1 relative to other quarters, given all of the sub-ads that come in early January from holiday devices?

Reed Hastings

It’s marginally better than other quarters in terms of percentage of the quarter’s numbers that have come in by the 20-F, but it is not hugely material.

Ellie Mertz

And then moving to questions about content, first, question is on the Disney deal. You made a bold and expensive move with your output deal with Disney. Presumably, the magnitude of the Disney deal will result in your devoting less content dollar repurchase elsewhere, even accounting for subscriber growth. What types of content are likely to be sacrificed as a result?

Reed Hastings

Well, the way pay one deals work is you pay for some and so the flow in 2016 as it hit in the second half of 2016 are relatively small in total payments, and you don’t really get a full load of the payment until 2018. So it’s a long way off, we’ve got a lot of content to look at between now and then, in terms of what generates the most viewing and satisfaction and a lot of flexibility to build the best service that we can by that point.

Ellie Mertz

What changed the attractiveness of the Disney content, which last year only accounted for 2% of your streaming hours, was it fully the ability to be exclusive? Was it the Lucasfilm acquisition?

Reed Hastings

It is pretty amazing that the Disney content, but it was on our service from Starz was only 2%, and it just shows you how much incredible great content that we have that content as good as the Disney content could only be 2%. And going forward, in addition to the straight Disney content where the Disney Marvel content and the Lucasfilm. So it will be bigger than it would have otherwise. But the rest of our content is growing. The big thing what we're excited about is the Disney content, once it eventually flows in it is fully exclusive to Netflix. and as we've been talking about, we're more and more interested in exclusive content until it hits that point of differentiation that we've articulated before as part of our content strategy. And that exclusivity allows us to have a differentiation in the long-term.

Ellie Mertz

How are the terms and conditions of exclusive pay one deals such as the recent Disney deal similar to or different from typical content deals?

David Wells

We don't typically discuss the terms on individual deals, I would say that, deals like the Disney deal and other output style deals tend to be more cash intensive upfront, but other than that are not remarkable anywhere.

Reed Hastings

And pay per film based upon the box-office performance.

Ellie Mertz

Are there any material holes in your content library? So in terms of studios and categories, do you feel you need to have?

Reed Hastings

I would say, not more than holes. There is vast amounts of additional contents that we want to acquire as we grow and the virtual cycle for us is to gain more subscribers and get more content, gain more subscribers, get more content and what propels our growth is that continuing content. There's no specific holes that as we'd like to get more movies, we'd like to get more privacy's in television. We'd like to have more originals. And in general, as we grow, we'll be able to deliver on that more and more for consumers.

Ellie Mertz

Netflix described its library in terms of free groupings, movies, serialized TV and proprietary contents. The first two buckets are extremely large compared to proprietary contents. Should we expect a large proprietary content that launches in the future? Does your hierarchy suggest that despite being small, the proprietary content's value is on par with movies and serialized TV?

Reed Hastings

Well, it's early for us on the proprietary original content. You will know a lot more, maybe on the July call after we've launched House of Cards and after we've launched Arrested. So we'll be able to comment a little more and at that point may make decisions about how much we want to invest in it, do we want to increase the investment, keep it about the same to last and we have a lot more knowledge. So, we'll take our time and towards the next six months just focus on the current originals.

David Wells

And I'd say the bar on that, we said before this before, but which was articulating again, the bar on the originals in fact, it performs in similar to other third-party licensed content that is exclusive. If the originals are exclusive for us than they are, we would look to do that better inside, if we can't and we wouldn't pursue that. There is the brand halo effects and the PR effects that we get from it and those are very, very interactive. but that comes from the exclusivity as well.

Ellie Mertz

These are more questions on originals. this year you will have four new original series on Netflix plus Lilyhammer. What are your plans for 2014? Presumably, we have some idea now, given the long lead times on original programs. What percent of content cost do you envision for original programing next year?

Reed Hastings

Again, we have made the decisions for next year in terms of what percent of budget will be original content. We're going to look at the results, look at the viewing and overall press attention, subscriber acquisition trends all of the factors before making those decisions.

Ellie Mertz

Have you planned to market House of Cards? What is your approach to marketing the show different from how traditional cable networks market their shows? Do you envision creating a section for highlight original programing within the Netflix service over time?

Reed Hastings

The huge benefit is that we don't have to advertise 8 p.m. on the Thursday night tune in. We get to let people know about the show and they can watch it anytime at their leisure. And so that let's just be much more efficient in our marketing and much, much focused on a specific date and time.

Mostly, we're going to be able to generate tremendous demand through our service by targeting the specific online ads on the service, the content for the people who will be relevant for. so we get tremendous viewing from our 33 million global members. Then in addition, we're also generating a lot of attention in certain cities doing a highly concentrated, large scale promotion to be able to see what the effects of ours to stimulate the creative community awareness and generally build a lot of buzz around those shows. So we're very much looking forward to that launch.

Ellie Mertz

For a few of Netflix's upcoming original programs, can you discuss the specific rights Netflix owns and the monetization strategies of the other right holders, which monetization channels, if any, does Netflix view as most complementary to its streaming business over time?

Reed Hastings

Well, I think that's something we've learned over time. If you look at HBO, they experimented and have had great success with DVD as a channel for their content. They did some syndication, but then they pulled back on some of that. And I'm sure we'll try some of the same things and trying to see what makes sense. The current originals mostly where our first window licenser and for example, on House of Cards, Media Rights Capital owns the other rights and will be monetizing those downstream from us. So we'll try different structures as we go forward, but primarily a focus on monetization on our platform.

Ellie Mertz

You said that Arrested Development could bump subscriber growth in Q2. can you point to any data that supports this view? Expressions of interest by network subscribers, surveys that point to interest or anything like that? How would you compare interest in Arrested Development to interest in other originals queued up this year, like House of Cards and Hemlock Grove.

Reed Hastings

Well, it's a great question. In the case of Hemlock Grove, it's a new property like House of Cards, and the same with Orange is the New Black. So that will take sometime to develop for those shows. Arrested is unique, because it's already got a big brand, and so it's good to be more front-loaded in its overall viewing and attention.

In terms of high data, it's very hard to predict what will happen in terms of membership in Q2. So I think what we'll do is, we'll be cautious, and it's not particularly built into our forecast. And then we will see what happens in Q2. And then from that basis, we'll have – be able to project going forward.

Ellie Mertz

A question on accounting for originals. Over what period of time are you amortizing the upfront cash spend on important originals this year, particularly Arrested Development and House of Cards?

Reed Hastings

Well the accounting for originals is similar to or is consistently the accounting for our whole library, which means we amortize in straight line over the license period. I would say, the question was asked about amortizing the cash. It's not the cash that gets amortized; it's the extent of that full title. And so when we have quarters like Q4 and you talked about Q1 being intensive for originals, we'll pay depending on the terms of the deal, heavy upfront payments, even upwards of 50% and then that content will come into window later in the year. So you'll see the cash come out in terms of the cash flow, but there's no offsetting expense. Some of that flows into prepaid content as you see and you'll see that cash be less as we go through the year and the expense starts to catch up.

Ellie Mertz

As you look at original Netflix content, what are your expectations or how it will perform in the U.S. and International market?

Reed Hastings

Very strong.

Ellie Mertz

How do you decide which original programming to invest in and stream? Do you look to reach certain segments of your sub-base or best available programming or other factors?

Reed Hastings

Well, again, we're at a very early stages, I think Ted's done a – Ted Sarandos has done a great job on different types of content; Hemlock Grove and House of Cards are quite different. I think you'll be very pleased with Orange is the New Black. So, and of course, that's the development of U.S., a huge winner. So I think it's just too early for us to have any great confidence. We're staying flexible, learning and we'll grow into original program step-by-step.

Ellie Mertz

A few questions on competition. Do consumers need to choose between Netflix and Amazon? In the past, you've referred to HBO and Netflix along the lines of baseball and football. Do you feel that way about Amazon too? As Netflix and Amazon both have exclusive content and original content, will it make sense for consumers to have both rather than choose between them? Do you think the two services will take on different identities and be the two leading digital cable networks in the future?

Reed Hastings

Well, some of this is already happened in the UK, where LOVEFiLM, Sky, TV NOW and Netflix has nearly no overlapping content. And as the press tone is shifting in ways to be getting both, they're getting three, as there are different channels, basically to surveys someone totally. of course, not everybody has infinite budgets ready, but his budget is tight as real competition for choosing us, if you need to choose. But I do think that many people will choose to get multiple services like we compete with HBO, that is we'll all have different shows and I will be competing for dollars and attention. But not have the same content.

Ellie Mertz

Can you help us understand the methodology behind the top 200 title comparative analysis? Do you use ratings, actual viewings et cetera?

Reed Hastings

We used actual viewing hours and again, in Q4 on our Netflix service in U.S., those would be for each title in there, not just a season, but a title of an entire show, how many hours that was viewed basically during Q4 and that's the methodology behind that?

Ellie Mertz

Moving to questions on international. on previous calls, Reed has stated his intentions to continue to re-invest in international expansions or once to get back to profitability. Can you update us on your current thinking on this topic?

David Wells

I can reiterate what we said last quarter, which was these two gating items or grating conditions, one is global profitability, which we're really pleased that we continue to demonstrate even with the modest launch in Q4, and the second condition being that we're pleased with the path of our existing investments. So those two conditions still hold.

Ellie Mertz

Two quarters ago, Reed spoke about raising the content spending in the UK. Give a sense where the extended offerings in the UK have impacted subscriber growth or churn in any meaningful way?

Reed Hastings

Yeah, absolutely. We've continued right from inception. And frankly, in all of our territories in Canada, Latin America and the different nations in Europe to expand the content and expanding the content has definitely increased viewing, decreased this churn, made this better. So we're very eager and ambitious to get more and more content on all of the services including the UK.

Ellie Mertz

Has the competitive environment in the UK evolved over time? In the UK, are you seeing different levels of net ad, churns et cetera given potentially more competitive environment?

Reed Hastings

The only change in the UK, and welcomes in there from our launch at the same prices have always been at, has been Sky's and TV Now, which launched in the fall. So that's increased. There is active marketing going on between us. As far as we can tell, both services are doing well also. It comes back to us; it may not end up as some game, we want to get the biggest piece of the pie. But it may be that people subscribe to multiple services.

Ellie Mertz

Can you tell us if the procurement changes made in Latin America had a material impact on sub-growth in Q4 or what's held for Q1 number?

Reed Hastings

I helped on a little bit in Q4, we'll help a little bit more in Q1 and we've still got projects to go.

David Wells

That was an incremental improvement.

Ellie Mertz

What penetration of sublevels that you need in any given country in the Europe or Latin America to reach break-even, roughly what is the time to achieving that now?

Reed Hastings

It will depend by markets and in some markets, you'll get that relatively quickly, others will take longer. And there's no precise level of penetration. It depends, for example, in Latin America, we'll end up at break-even at lower overall household penetrations, because the Internet is at lower penetrations. So I would say each market is unique in this way.

Ellie Mertz

In the past, you've said you believe Netflix can grow its domestic sub-base 2x to 3x out of HBO long-term. what are your expectations in the various international markets that you have entered?

Reed Hastings

So, let's see our hopes would be that we should get to similar house Internet or broadband household penetration levels as we can in the U.S., but until we actually prove that that's possible, we're a little cautious on forecasting it. So in principal, when we look at Internet usage or YouTube usage or television, pay television and free television. It's pretty ubiquitous across all these societies. so the notion that over 10 or 20 years, Internet TV is that strong around the world as it is in the U.S., it's pretty sound.

Ellie Mertz

Can you achieve long-term international contribution margins equivalent to U.S. without the same amount of scale in the single-digit?

Reed Hastings

Yeah, I think we would need the same amount of – the contribution margin is a factor of the scale. so I think we would need to get to that at scale. It's fairly competition, I mean I would just add, add-in competition. So those two things are the primary determinants of long-term margin.

Ellie Mertz

You expect more modest quarter-over-quarter improvements in international losses beyond Q1? is that because of lower sub-ad expectation or an increase in spending relative to sub-growth?

Reed Hastings

A little bit of both.

Ellie Mertz

And a question on the DVD business; you appear to be marketing DVD subscriptions to streaming only subscribers again. But now we see more e-mail promotions, offering a free month trial to the DVD program. You really want to push people back to DVDs? Isn't that a bit confusing to consumers, given your intense focus on streaming being the future of media consumption?

David Wells

I would say, this is David here. I would say it was a program that we did around the holidays and into January. I think you'll see us view this sporadically, I wouldn't describe it as a large program. It was incrementally positive to our DVD subscription. And we gave a lot of credit to them, 12 to 18 months ago that we weren't doing enough, in terms of monetizing some of the sales search opportunities on the DVD, on the website and so forth. And I think we've cleaned a lot of that up, and e-mail programming campaign that you're talking about is an evidence of doing a little bit. We test a lot of this, and usually when we do something, it's going to be an incrementally positive.

Ellie Mertz

So a question on Open Connect. could Super HD and 3D streaming periodically be expanded to ISPs without Open Connect, without significant engineering investment? Ask another way, is Open Connect a prerequisite for technical reasons or more for strategic reasons?

Reed Hastings

It's a mix of both. I think when companies deal with new features like Super HD, they focus on newer platforms whether that's Siri only available on iPhone 5, say or something like that. It both get people to adopt to new platform and allows you from an engineering side to concentrate on a simpler use case and being able to support on Super HD and 3D is demanding. And Open Connect is free to our ISPs. And so we don't anticipate much of a problem. and I think what we find is by doing that we can be more efficient not going through middlemen?

Ellie Mertz

A question on change in delivery cost. Did Open Connect drive delivery cost down in Q1, or should it in Q4 or is it better pricing from suppliers?

Reed Hastings

The delivery cost, I'm not sure you can believe into that as a result. I would say that our Open Connect program has investments that are front-loaded. So to the extent that we're rolling out our Open Connect program, there's a little bit of expenses that are loaded into Q4 and into 2013, depending upon the pace of our rollout and that those flow should moderate going forward. I think the question is in reference to letter, we said that our U.S. contribution marginally better, because of just some delayed expenses that will show up and relative to planning in Q1 and Q4.

David Wells

Thank you the clarification. Yeah, some timing allowance expenses for Q4.

Reed Hastings

In general, delivery is something that's relatively small percentage of our total cost, it works quite well. So it's relatively inconsequential.

Ellie Mertz

A question on the social fit. Please discuss Netflix's experience with social media integration in international market? could you provide some common examples of how Netflix uses social media in international markets? how do you expect social integration to impact your U.S. business?

Reed Hastings

It will be a nice thing for us. I don't think it's going to be huge. It hasn't been huge for us internationally. It's certainly segmented. There's a section of the group within each country that loves social and they are really into on Netflix and probably, every other sites that they use. and then there's a lot of people for whom that's not why they're there, Netflix in terms of a social aspect. And of course, over time, those ratios will shift. But for now, all of our social work really caters to a little specific, typically younger, but very social centric demographic. So it's a good investment. It's making good progress. We're thankful the DPPA passed the change to it and we'll continue to make progress on this front.

Ellie Mertz

Some questions on the financials. how should we be thinking about 2013 in terms of profitability and margins, similar to 2012 as a heavy investment year or here we'll start seeing leverage in the models; if so, how much?

Reed Hastings

Well, we should see leverage in the model. we haven't made decisions in the back half of the year on international expansions. Obviously, that will matter as well.

David Wells

And we probably have 7 million reasons not to give full-year guidance right here. So we'll avoid doing that this year.

Ellie Mertz

We might also make a point that we thought, considering the leveraging in the model in 2012, $106 million segment where we saw 700 basis points of margin expansion.

Reed Hastings

Yeah. we can be confident that it won't be as big as that.

Ellie Mertz

As profits overall are somewhat exceeding guidance, do you think you might increase investments in marketing, content and your additional country rollouts in the near to medium term?

Reed Hastings

No. That's not directly affecting us. As we outlined in the letter, we're feeling good about those plans.

Ellie Mertz

You talked about the goal of 100 basis points of contribution margin expansion sequentially in domestic streaming, but you don't indicate how far out that goal extends. Can you talk about what you're thinking is related to long-term i.e., multiple years out, domestic streaming contribution margins?

Reed Hastings

It will be a function of competition and how much of the market, the total addressable market that we can collect. So right now, we're focused on the target of expanding that routinely by growing faster basically in our content, but expanding our content expense.

Ellie Mertz

So this is the size of the off balance sheet content liabilities.

Reed Hastings

So I think the question usually I get on is related to the contractual obligation table. The streaming obligations were $5 billion as of $930 million as of the end of Q3. That corresponds to a $5.6 billion number as of the end of 12/31. $2.5 billion is added on the balance sheet to $3.1 billion that's not on the balance sheet.

Ellie Mertz

Do you expect to be free cash flow positive for the full year?

Reed Hastings

We don't provide full-year guidance on that.

David Wells

Can you give a sense of how much money you plan to raise in the debt offerings? Did you consider you being soft, with the potential new debt financing be straight debt or could it be convertible debt. When would it occur?

Reed Hastings

The no on stock, no on covert, I think the plans that we put in there are still sort of an opportunity in exploration base. It's really based on the 20 plus year low that we see in the debt market. It's a good time to lock in very low-cost long-term capital. So we'd be remiss not looking at that opportunity.

David Wells

Will additional financing be needed if you decide to open new international markets in like 2013 or early 2014?

Reed Hastings

No.

Ellie Mertz

The marketing cost in the Netflix streaming has fallen 24% year-over-year. Yet, you've been able to grow your top line significantly. How sustainable is your Q4 marketing spends and how do you think you're gaining efficiencies in marketing?

David Wells

Very sustainable on the Q4 marketing spend and the second part of that, late efficiency; the late efficiency comes because most marketing is on members telling their friends about Netflix. It's not the ads that we pay for. And as we have more and more members and as they are happier and happier with the service, the net benefits to growth and then don't need as much paid marketing.

Reed Hastings

I would say also – but in the letter about if we're expanding our content expense and that has benefits in terms of getting people excited about the sign of retaining better, all of that is a quasi marketing expenditure. So the rest are developmental marketing expense or content expense.

Ellie Mertz

Will the company break out cost of subscriptions versus fulfillment expenses for the quarter?

Reed Hastings

Not likely. Fulfillment has grown to be a pretty relatively small portion of our cost of revenues as our DVD business continues to scale down with small portion of content revenue.

Ellie Mertz

Great, that's the end of our e-mail questions. Now I'll turn it back over to the operator to take live calling questions.

Operator

Yes, ma'am. (Operator Instructions) Our first question comes from the line of Mark Mahaney with RBC. Please go ahead, your line is now open.

Mark S. Mahaney – RBC Capital Markets

Hey, great thanks and congrats on the quarter, I don't think I've said that on an earnings call in five years. Reed, I know you don't run the business near term, but congrats on the quarter anyway. In terms of rebuilding the brand, Reed you talked a year ago, year and a half ago and said, this will be a multiyear process in terms of rebuilding the brand. As you think about and survey your customer base now, do you think you've rebuilt the brand hit that you – do you think you've recovered that brand hit that you took in the wake of the controversies?

Reed Hastings

No, not entirely Mark, there's still an echo in the grove. And so we still are extremely thoughtful and careful about what we're trying to do because it wouldn't take much to have the issue flare up again or for us to lose track. So you might say we're on probation at this point. So we're out of jail. But we've still got, as we had initially talked about a two years timeframe, we still got a year-and-half of probation.

Mark S. Mahaney – RBC Capital Markets

And then one follow-up question, in terms of the content requirements or likes, the wants of your subscriber base, have you seen a noticeable change in the satisfaction level of your subscribers with current content or do you still see – there's always been a gap, but do you think that that gap has kind of narrowed a little bit over the course of the last three to six months?

Reed Hastings

Yeah, that would be mostly what drives the improvement in voluntary retention. It's that satisfaction with the content, in addition the satisfaction for the user experience, how quickly and easy it is to chose, how well the personalization works, how well the streaming works. So, that all comes together and gives them the satisfaction.

David Wells

And Mark, I would say that the other contributor to that is people two to three years ago, when they first experienced a streaming offering had expectations of a DVD full content library. I would say those people are starting to be a little bit more aware of what's available in an Internet channel and in an Internet network, offering like we have. So the expectations gap might be narrowing as well.

Mark S. Mahaney – RBC Capital Markets

Thank you, David.

Operator

Thank you. Our next question comes from the line of Doug Anmuth with JPMorgan. Please go ahead, your line is now open.

Douglas T. Anmuth – JPMorgan Securities LLC

Great, thanks for taking my questions. I just wanted to ask about content costs, sort of the outlook for 2013, if you could give us some sense of how you're thinking about the increase here and perhaps, in relation to what you did from 2011 to 2012. And then just secondly, can you give us more detail on how you improved that involuntary retention? You mentioned processing payments and recovery members better, so if you could give us more color there? Thanks.

David Wells

Yes, Doug. In terms of content cost, we continue to expand our content libraries and we expect that to continue to increase. It's going to increase slower than revenue. So from that, you can infer that the year-over-year increase for 2013 would be less than the increase that we saw in 2012. And then the second piece of that question was around, how we improved the involuntary retention numbers and that we drew looking at a number of optimization in terms of how we handle folks that go on payment hold.

Douglas T. Anmuth – JPMorgan Securities LLC

Thank you.

Operator

Thank you. Our next question comes from Youssef Squali with Cantor Fitzgerald. Please go ahead, your line is open.

Youssef H. Squali – Cantor Fitzgerald Securities

Thank you very much. Hi, Reed and David. Just a couple of questions to follow-up. Reed, you spoke about offering more personalization on the sites and if my memory serves me right, I think last time you've talked about it, it was several quarters ago. And I think you talked about maybe offering personalization at least of queues by year-end. So one, I wanted to see what the hold up there was and the second, what other ways can you improve personalization on the site? Then I have a follow up.

Reed Hastings

Youssef, we're still in testing on the features of some Netflix profiles, where you set up an exclusive. I'd say you and your kids, your spouse and then each person gets their own area. And we're trying to find models that give great benefits to consumers, but are also very simple. And so that's where we're involved in a lot of testing and when we get that to a great state, then we'll roll it out to upfront.

Youssef H. Squali – Cantor Fitzgerald Securities

Is that still an imminent turn off the launch or has the date on that been announced and put back on hold?

David Wells

It's not the M&A. We're still in testing mode. We think we got to do something like that. You don't want to roll it out and then change it a lot. So you want to do a lot of the tuning in test mode. So sometime over the year, I'm sure we'll want it and so when you find out a model that works really well without testing, but it's not imminent.

Youssef H. Squali – Cantor Fitzgerald Securities

Okay, great. And then just lastly have you integrated with Facebook for more sharing of social personalization? I was wondering if you'd have any interest in participating in Facebook's Gifts program, which is something, I'm sure you're aware that they launched lot too long ago and they have other retailers like iTunes et cetera. Is there anything that would preclude you from wanting to participate or being on that program?

Reed Hastings

No there is nothing that would preclude us.

Youssef H. Squali – Cantor Fitzgerald Securities

Is there interest on your end?

Reed Hastings

I should know more about it as a Facebook Board member. But it's very new. And so I'll take your hint, that it's a good thing and I'll go and spend some time on it.

Youssef H. Squali – Cantor Fitzgerald Securities

Okay, thanks a lot, congrats.

Operator

Thank you. Our next question comes from Scott Devitt with Morgan Stanley. Please go ahead, your line is open.

Scott W. Devitt – Morgan Stanley & Co. LLC

Hi, thanks. Reed, now that the U.S. business has gotten back to this level of strong growth, I was just wondering if you could revisit that U.S. market opportunity, how you're thinking about it, that $60 million to $90 million figure and the points of friction that you're facing from here to grow that U.S. sub-base to a much larger level?

And then secondly for David, in the 1Q guide, I think you noted that you're not specifically attributing any subs to Arrested Development, but is that also the same thing for House of Cards? Is there no specific attribution for House of Cards in 1Q? And are you planning any specific TV spend for either of those two shows? Thanks.

Reed Hastings

Scott, think about it in terms of the content layers. So we're $27 million domestic now. So the question is do we have good enough content to say, get to $40 million. And then with that incremental content budget, can we improve the content, such that with that incrementally better service, we can get to $50 million. And then similarly, we got more money we can spend on more content.

So that's one big a growth factor. And second is the overall change to Internet TV. It's not just us that's benefitting from this. If you look at Hulu's numbers over last year, they doubled from 1.5 million to 3 million subscribers. So people around the world are interested in Internet television since you can click, watch, pause, control, choose; it's just a better paradigm. And so as that tailwind continues to develop, that's very helpful.

And then finally, it's what happens in the consumer electronics space. It was only six to seven years ago that the iPhone came out. We've had tremendous, right now on iPhone 5. So if you think about 6 or 8 years from now by extension, we'll be at the iPhone 10 and how incredible will that be for not only viewing video, but maybe controlling video around all of your house and choosing and how immersive and all of that helps Internet video services like our own. So those are three big factors, the content growth as we grow, the general trend towards Internet TV and the consumer electronics ecosystem.

David Wells

And then Scott, on your second set of questions on House of Cards, we think it is going to be a pretty small benefit for Q1. We've talked about how – overall it's a generally small share of ours, really happy about the quality and the fan fare that we're getting with the show. And now we think that those would be but overall pretty small benefit we think to subscriber editions. And then TV spend for House of Cards, there will be some media spends likely very little TV, like focus again on sort of influences in big markets.

Reed Hastings

So would it be fair to say David, that its' a very small impact of House of Cards that's modeled into our guidance forecast?

David Wells

Yes.

Reed Hastings

And since we have no data to base it on, that's the conservative and correct approach. But some of us are optimistic that it may in fact be substantial. But we really don't know and we don't want to count on it until it happens.

David Wells

I would say that's fair revenue.

Scott W. Devitt – Morgan Stanley & Co. LLC

Great. Thank you.

Operator

Thank you. Our next question comes from Tuna Amobi with S&P Capital IQ. Please go ahead. Your line is open.

Tuna N. Amobi – Standard & Poor's Investment Advisory Services LLC

Hi, thank you so much. So again, this question is for David. I'm thinking about how you manage your working capital and swing that are logging from the content licensing payments for regional? I'm just kind of wondering if there is perhaps, a better parameter back in '08, kind of reduced the swing of free cash flow, not necessarily quarter to quarter. But as you think about some of the leverage that you might have, for example perhaps deferred revenues and some of their items, I'm wondering if it's the best way to think about that, just kind of managing it to the P&L expense as opposed to something that kind of gives you a little bit more control, granted that the originals are the highest swing factors. Any thoughts on that would be helpful.

Reed Hastings

I think it’s the only – not quite clear on your question. But if we looked into alternative methods in terms of joint ventures and other vehicles to reduce that cash consumption upfront might be the only available method to assume that. We prefer the simplicity and we may get there sometime down the road. But in terms of the present course, overall the content spend on a regional is a relatively small part. It’s outside in terms of our cash because it’s so lumpy up in the first couple of quarters.

Tuna N. Amobi – Standard & Poor's Investment Advisory Services LLC

And just a follow-up on that – how you think about managing the risk of your original content in terms of showing that you actually collaborate with third-party producers versus showed that you actually own outright? And how does that factor into your calculations of cost per viewing hours in terms of your commitment to either kinds of shows? Thank you.

Reed Hastings

It’s Reed here. The good news is, any one show isn’t an ongoing commitment. So it’s a relatively fixed bound. And it might be that at some point, we produce the show that’s not very good. But what that really means is, we only get a little bit of viewing on it as opposed to a lot of viewing. And when you think about the size of any single original and the size of our total multi-billion dollar per year content budget, it’s not a huge risk.

Tuna N. Amobi – Standard & Poor's Investment Advisory Services LLC

Thank you.

Operator

Thank you. Our next question comes form the line of John Blackledge with Cowen & Co. Please go ahead, your line is open.

John R. Blackledge – Cowen & Co. LLC

Thanks. Two questions, the first on streaming content spend; given the current level of streaming content spend after several years of large step ups; is there a normalized longer term rate of growth or range of growth of that we should be considering or will we potentially see lumpiness on a year-in year-out basis, depended on available content? And then for David, as we think about a potential debt raise, is there a certain level of cash on the balance sheet that you're comfortable with? Thank you.

Reed Hastings

In terms of the lumpiness, I presume there will be some quarters where it got a little bit lumpy, where we signed a big deal, but generally any big deal, we would know about several quarters in advance, so we would have that visibility to build in and to let everybody know, and then return to the kind of margin expansion that we're targeting. And we're feeling our way along as we grow in the market in creating the service and thus far we're focused on the 100 basis points a quarter versus some specific operating model, because we want to get the operating model to be better and better and better. And to do that, we have to really feel our way along and make sure that it's consistent with increasing viewing, and with really good or improving on voluntary retention, I'll turn it over to David on the cash.

David Wells

And John, on the cash as long as the cost are low, more cash is better, but I would say this is again as the opportunity presented by the debt market, and the ability to get really low cost long-term capital, and for us to preserve the flexibility, if we feel massive success with original to preserve the flexibility to expand that program, and to develop more down the road. So I don't think there is a magic number this is about sort of long-term planning for the business.

John R. Blackledge – Cowen & Co. LLC

That's great. Thanks so much.

Operator

Thank you, sir. Our next question comes from the line of Carlos Kirjner with Sanford Bernstein. Please go ahead.

Carlos Kirjner – Sanford C. Bernstein & Co. LLC

Thank you. I have two questions; one on content, one on the market potential. First on content, when you lost Starz you said that it accounted for a small portion of viewership time and benefit slots that really impact on customer acquisition churn et cetera, suggesting that no specific content deal has material impact on the customer metrics. If you can't lose any specific content deal, which will immediately impact on the metrics. How do you think about the positive impact of content dealer such as Disney's or Time Warner's, where presumably you are paying a premium, for example for exclusivity or even how do you think about investments in original content?

On the market potential, if you grow your content offer as you described a few minutes ago and succeed in getting 50 million or 60 million households in the U.S., how do you think the cable companies would do which changed their broadband pricing levels or structure? Thank you.

Reed Hastings

Sure, Carlos, that's a good question, which is why do we talk so much about increasing the content about propelling our growth, but when we lose content, we say it doesn't matter. And I think the insight is your part about any specific piece of content, I think if we lost enough content that would definitely decrease viewing. And similarly, when we increase content, we have to increase it by a lot to make a difference, adding just one movie here or something like that or one show isn't going to make a huge difference. The general view, we have is sometimes the content additions are so small, 1% of viewing that we are not to see a big difference, but that will increase, and if we do a lot of that that will help.

And then second on in terms if we get to 50 million or 60 million how does the relations with cable networks change. I think we always were building great audiences for them, if you look at what we've done for Breaking Bad in terms of building a bigger audience for viewing on AMC, and if you look at Mad Men, that's a great win-win, where we are incredibly good at the prior season. They have got the current season and they get bigger and bigger audiences.

And then second, if it's off air like ADC's lost, then I think it's pure incremental money for them, the fact that we will have to monetize it down. So we don't see a huge conflict there in that licensing dynamics.

Carlos Kirjner – Sanford C. Bernstein & Co. LLC

Reed, do you think there is a conflict potentially with the cable companies like Comcast and Time Warner Cable in COGS? If you increase your subscriber levels and using their price to transmit the bids for the year, and it could increase the pricing of cable broadband access??

Reed Hastings

The cable broadband is very profitable for them and the more that people want to do high definition Skype and high definition Netflix, it's inevitable that there is going to be new high speed packages that are more successful for those ISPs. And so they have got an incredibly profitable great business moving data, and that's great for them. It doesn't conflict with us. In fact where we like high definition Skype are the critical applications that help them drive more adoption of the higher end packages, and in that way we work really well with them.

Carlos Kirjner – Sanford C. Bernstein & Co. LLC

Thank you.

Operator

Thank you. Our next question comes from Tony Wible with Janney. Please go ahead, your line is open.

Tony Wible – Janney Montgomery Scott LLC

Hi. Do you guys believe that Amazon was in their bidding for the Disney content and what's your appetite for chasing down Sony Pay 1?

Reed Hastings

Tony we don't know on Disney Amazon and Sony Pay 1, our appetite frankly was for Disney, it's strong and we’re interested and we will see how it works out. There is no specific piece of content that we must have, and that's just the bidding negotiation.

Tony Wible – Janney Montgomery Scott LLC

Perfect. Thank you.

Operator

Thank you. Our next question comes from Nat Schindler with Bank of America. Please go ahead, your line is open.

Nathaniel H. Schindler – Bank of America/Merrill Lynch

Yes, thank you. So if you look at your net sub adds, and then estimate some growth sub add that you had coming in for the quarter. In domestic streaming, you said in the past of 30% of those or third roughly you touched within the last year in our returns, has that number changed, and could you think that longer than a year, how much of your market, the total market have you touched at this point, do you believe over the course of your business?

Reed Hastings

It all depends on, Nat on how you count an entity. You count a household where you will make out and they try both under separate email. Lots of people have multiple email addresses and several of them are willing to enter multiple credit cards to get multiple free trials. So there's no clean motion of that. We can tell you how many email addresses have we touched, but mapping that into people and households is pretty tricky.

Nathaniel H. Schindler – Bank of America/Merrill Lynch

Makes sense, thank you.

Reed Hastings

Yes. And Nat on your first question, it stayed roughly, about the same in terms of percent

Nathaniel H. Schindler – Bank of America/Merrill Lynch

Okay.

Operator

Thank you, sir. Our next question comes from Daniel Ernst with Hudson Square. Please go ahead, your line is open.

Daniel Ernst – Hudson Square Research, Inc.

Thanks. Good evening. Thanks for taking my call. Three questions if I might, first kind of big picture on, how you're looking at the business and growth. Profitability has been reasonably above expectations in the last couple of quarters, and guidance for the coming quarter? Historically you guys have tended to manage perhaps not making too much profits and always willing to invest in growth, and how you are thinking about that in terms of new market rollouts or acquiring new content to really continue separate yourselves from the competition sort of or on investing on your product expectations versus growth investments?

And then secondly in a related comment, back in the day, eight, nine years ago, we use to kind of get market-by-market updates, you are at X percent penetration in San Francisco and we got the profitability in X number of months, can you give us some sort of directional color like that on some of the international markets in Europe and maybe an update on Latin America there?

And then third sort of viewership question, I know people asked of this before generally and could use a lot of color. But what kind of is the mix of viewing between connected devices to the TV, the Xbox, and there is an

Apple TV and DVD players and TVs that have Netflix built in versus tablets, and I think computers and how that looks domestic versus international, where perhaps all those devices are less connected to TVs in Europe or Latin America? Some color on how that, mix in usages fits. Thanks.

Reed Hastings

Daniel, you started pretty awfully nicely about talking about growth of above expectations last year, but I think you were obviously confused with the different companies, since last year was difficult on that front. But in general, we are pioneering this new service, Internet TV as are other firms, and from a macro level there is a lot of great growth factors because Internet makes certain user experiences, much more enjoyable at lower cost, and Netflix is propelling our growth, and we are very excited about the growth.

In terms of penetration, in the DVD days, we were operating in the San Francisco Bay Area for several years with local delivery, before we were doing the rest of the country. So that's why we've used that as the comp. We don't really have an equivalent each, the U.S. is reasonably uniform in terms of DVD viewing. Each nation is quite different, and we wouldn't want to say every nation is going to be like Canada. So there's no useful proxy in that way.

Then finally, your question was on viewership, and some nations are more Smart TV centric, and some are more PS3 centric, and Xbox centric. But overall, you see a lot of similar trends, which are tablets, are growing somewhat in the absolute and somewhat at the replacement of laptops. Smart TVs are selling to people who want to use and Netflix is the most important application on a Smart TV. Then all of the individual devices like an Apple TV are really cool and doing well. So, the whole internet getting to every screen is just a big secular story that's happening and benefitting us.

Daniel Ernst – Hudson Square Research, Inc.

All right, thanks. Really, but just to clarify, we were talking about the last couple of quarters being profits above expectations, and your guidance there for the next quarter?

Reed Hastings

Yeah, Dan let me take a stab at that, in your part A. In the past Netflix has been very good about thinking about that net incremental $1 million or $5 million investment. It's better in content. It's better in marketing. It is better in improving, our interface and our products. We continue to do that. We are never perfect in sort of finding out that optimal frontier point, but we still continue to think like that in terms of that additional investment whether it's better place in an existing market in a near market and product or in our content offering in the Netflix or international

Ellie Mertz

Great, thank you, that’s all the questions we have time for. We really like to offer some closing remarks.

Reed Hastings

Youssef if you’re still on, we are on Facebook Gift and I’m sure it’s a huge opportunity. Thank you all for visiting Netflix teleconference and we look forward to seeing you.