

FINAL TRANSCRIPT

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NFLX - Q4 2010 Netflix Earnings Conference Call

Event Date/Time: Jan. 26. 2011 / 11:00PM GMT



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

CORPORATE PARTICIPANTS

Reed Hastings

Netflix - CEO

Deborah Crawford

Netflix - VP - IR

David Wells

Netflix - CFO

PRESENTATION

Operator

Good day, everyone, and welcome to the Netflix fourth-quarter 2010 earnings Q&A session. Today's call is being recorded. At this time for opening remarks and introductions, I will turn the call over to Deborah Crawford, Vice President of Investor Relations. Please go ahead.

Deborah Crawford - *Netflix - VP - IR*

Thank you and good afternoon. Welcome to the Netflix fourth-quarter 2010 earnings Q&A session. We announced our financial results for the fourth quarter at approximately 1.05 PM 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, this call will consist solely of Q&A and we are going to conduct the Q&A via e-mail. Please e-mail your questions to ir@netflix.com.

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 22, 2010. A rebroadcast of this Q&A session will be available at the Netflix website after 6.00 PM Pacific Time today. Before we begin the Q&A, I'd like to turn the call over to Reed.

Reed Hastings - *Netflix - CEO*

Thanks, Deborah. I'd just like to acknowledge that Barry McCarthy has been our CFO and my partner for the last 11 years and there's no way we would have gotten to 20 million subscribers as fast as we did without his incredible work. And, I'm thrilled to be able to introduce to you David Wells who is our new CFO.

David Wells - *Netflix - CFO*

Great, thanks, Reed. This is David. I'm glad to be joining you on the earnings call this afternoon. I've got quite a legacy to follow. I've been part of the Netflix team for 7 years and in the background of this call for many of those years, so I look forward to speaking to many of you in the coming weeks. But, I know that you're here for Q&A, so let's get to questions.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

QUESTIONS AND ANSWERS

Deborah Crawford - *Netflix - VP - IR*

Great. The first question is from Youssef Squali at Jefferies & Company. How should we think about overall content spend in 2011 versus 2010, mix of international and domestic digital rights?

David Wells - *Netflix - CFO*

Youssef, I can actually take that. This is David. I think you should mostly think of it as domestic. If you think about the guidance that we gave for Q1 and you scale that for Q2 and you think about the \$50 million operating loss we talked about in Q3 and 4, it's not hard to get to a position where most of that spend is domestic.

Deborah Crawford - *Netflix - VP - IR*

The next question is from Arthuros Mangriotis at Fox Point Capital Management. Please elaborate on your decision to reduce focus on churn. Even though net additions are ultimately the important statistic, I would have thought that managing churn would be a great way to make sure you are satisfying your customers.

Reed Hastings - *Netflix - CEO*

Arthuros, it's Reed here. I guess I'd say you don't really manage churn. You manage satisfaction and, then, from higher satisfaction comes more word of mouth driving SAC down and new starts up and churn down. And, what I've come to realize over the years is that net adds is really the best indicator of that and this evolution in our part reflects an internal evolution over the past couple years where I find myself not particularly paying attention to churn and SAC and much more to net adds, which again is the best indicator of the satisfaction. And, so, that's the underlying reason for the evolution.

Deborah Crawford - *Netflix - VP - IR*

The next question is from Heath Terry at Canaccord Genuity. How do marketing deals like the Netflix buttons on remote controls compare to your existing subscriber acquisition cost levels?

Reed Hastings - *Netflix - CEO*

Heath, we don't know for sure yet because I guess we would say we don't know the effectiveness of the buttons. It feels like a great option and, once they're in the market, which would be in the middle of this year and then more later in the year, we'll be able to study really how much consumers use them. So, we're optimistic on it. We think it's a great direction but we don't have any hard evidence yet and we won't probably for a year.

Deborah Crawford - *Netflix - VP - IR*

Second question from Heath. Is the improving market for online advertising impacting your online SAC level?

Reed Hastings - *Netflix - CEO*

Not substantially, Heath. It's been pretty steady for us. The big thing that improved SAC is that we didn't spend that much on marketing in the quarter because we're spending so much on streaming. And, when you spend less on marketing you can think of it as skimming the market or think of it as we get the flow over from the prior quarters kind of brand build up, it carries us.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

And, when we go into Q1, we'll spend a little more on marketing and SAC will be a little higher. So, it's generally in the right direction, but not as low as it was in Q4.

Deborah Crawford - Netflix - VP - IR

The next set of questions are from Mark Mahaney at Citi Investment Research. First question, what can you disclose about the overall usage patterns of streaming-only or streaming-mostly subscribers versus your DVD rental subscribers? Do they end up consuming materially more video content or about the same?

David Wells - Netflix - CFO

Mark, this is David. In general, we don't parse out the behavior, but you can imagine that people that are coming in streaming only or mostly interested streaming will consume more than the folks on a hybrid plan. But, I will say that across the board on both plans people do tend to consume more video when they do participate in streaming. So, for the folks that avail themselves of the streaming offering, their overall video consumption goes up.

Deborah Crawford - Netflix - VP - IR

And, the next question from Mark, can you provide more color on how you were able to drive down SAC and whether you believe the current level is sustainable?

Reed Hastings - Netflix - CEO

Mark, I think I just hit that in the question before so let's go to the next one.

Deborah Crawford - Netflix - VP - IR

The next question is why would operating margins decline from 15% Q1 domestic guidance to 14% full-year guidance?

David Wells - Netflix - CFO

Mark, this is David. 14% is a target, so some quarters might be 13%, some might be 15%. I think we addressed in the earnings letter why we're going to be a little bit heavy in Q1. We've identified a trend in our growth in shipments a little bit too late to put that to work to streaming and so we put a lot of it to work in marketing and we'll be a little bit heavy on income in Q1.

Deborah Crawford - Netflix - VP - IR

The next question is from Ben Rose at Battle Road Research. Are the cable service providers dyed-in-the-wool competitors or are there any scenarios under which you might partner with them?

Reed Hastings - Netflix - CEO

Well, see with the cable company, we've got a natural partnership with the broadband services group which is highly profitable, wants to increase their reach and the speed at which their consumers buy packages. So, with the broadband side, there's a complete and natural partnership. With the video side, we're a channel, we're sort of tolerated. We're not a big threat but it's hard to see why it makes sense for them to help us grow.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Deborah Crawford - Netflix - VP - IR

Next question is from David Miller at Caris & Company. Reed, against the backdrop of other distribution services bidding up for the content in the streaming window, what is your feeling about either acquiring an equity interest in the studio or, at the very least, starting one yourself? With creative financing, you could produce script-driven content on your own at very little cost relative to the size of your P&L.

Reed Hastings - Netflix - CEO

David, generally, I'm a believer in circle of competence and it's really easy for companies, as they grow, to step out of that. And, in particular, when we start taking creative risks, that is reading a script and guessing if it was going to be a big hit and who might be good to cast in it, it's not something that as fundamentally a tech company or a company run by a tech CEO like myself is likely to build a distinctive organizational competence in. And, so, we think that we're better off on letting other people take creative risk, get the rewards for when they do that well. And, then, what we do is focus on matching the different products that are made with the right consumers, the sort of very technological aspect of matching it and streaming it. So, I would say that the scenario that you outlined would be quite a change in direction and quite unlikely.

Deborah Crawford - Netflix - VP - IR

Next couple of questions are from Ryan Hunter at Wedge Partners. First, the latest reports on the HIS Screen Digest has home video content, DVD, VD and VOD down about 4% to \$18 billion in 2010 from \$19.2 billion in 2009. This has been the trend for the past few years. At what point does the market opportunity contraction start to impact Netflix?

David Wells - Netflix - CFO

You want me to take it? I'd say in general, Ryan, that VOD space, we've gotten this question time and time again. There's a lot of competitors in the VOD space. We've seen it in the fourth quarter as actually being a benefit through our 28 day deals. We've done a year with the 28 day deals. We see record low churn, record low SAC and record growth for us, so, I think it's working for us. And, I'm sure you saw the Red Box announcement in the fourth quarter that was a little bit new-release centric so I think it hit them disproportionately, but I think what you're seeing is an increase in the VOD as a result of the dynamics of the marketplace today. Did you have anything else?

Deborah Crawford - Netflix - VP - IR

Second question from Ryan. How is a gift recipients accounted for in the subscriber count? What was the impact from the gift subscription promotion during the holidays and what is the expected churn rate for these subscribers?

David Wells - Netflix - CFO

Ryan, I can take this. This is David. Gift subscribers are counted in the subscriber count at the point where they actually enter the service, so, once they actually redeem their certificate. The impacts from gift subs relative to last year was relatively flat with 2009, so, there's not a whole lot of impact. The majority of the growth that we saw in this fourth quarter was not related to gift subs. And, then expected churn rate for these subs, we don't generally comment on different segments of the business, but as you can imagine, they retain at slightly lower rates than somebody who comes in and pays directly.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Deborah Crawford - *Netflix - VP - IR*

The next question is from Nat Schindler, BofA Merrill Lynch. Has Amazon's acquisition of LoveFilm affected your plans to enter Europe and what competitive advantages do you have over Amazon LoveFilm in the UK and Europe?

Reed Hastings - *Netflix - CEO*

Nat, we're not quite sure what to make of it, obviously Amazon was in DVD rental before, sold that interest to LoveFilm and then bought back the whole company, and I think we're just going to have to take a couple quarters and see what they plan to do with it. And, in the meantime, it doesn't directly affect our plan. There's vigorous competition in all these markets, so, we're full steam ahead on our plans.

Deborah Crawford - *Netflix - VP - IR*

Next question is from Imran Khan at JPMorgan. Could you please give us some color on what percentage of streaming content consumption is television shows versus movies?

Reed Hastings - *Netflix - CEO*

Sure, Imran, what we said before is it's roughly half and half now, and there's some variation quarter to quarter but that's a rough range.

Deborah Crawford - *Netflix - VP - IR*

Next one is from Ingrid Chung at Goldman Sachs. You've spoken about geographic expansion beyond Canada in the second half of this year. If you can't tell us which countries specifically are most interesting to you, could you tell us what some of the characteristics are of an attractive market, other than high broadband penetration? Would you want to be in a market with high or low pay TV penetration, or does that matter?

Reed Hastings - *Netflix - CEO*

Ingrid, it's a more complicated question, as you probably understand, than just pay TV or not. It's really the best use of the dollars for building the business in a country that is likely to be a sustainable source of profit. And, so, that's a mix of how competitive it is, how good the broadband is, what content rights we can get, what's the economic growth rates, what's piracy ... boy, there's a whole ton of factors underlying that. But, what I would say is wherever we go next is just one building block, and our hope is to be able to go country by country and to expand quite rapidly in 2012 and 2013, assuming we continue to see the kind of success that we've seen in Canada.

Deborah Crawford - *Netflix - VP - IR*

The next couple of questions are from Brian Fitzgerald at UBS. Can you give us a sense of how the newer free subs are converting to paying subs from Canada or from most free subs that are part of the extended 4-week offer? How does it differ from the historic conversion rate?



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Reed Hastings - *Netflix - CEO*

I would say, Brian, as we grow, we would expect-- and with streaming only, it's a little more casual relationship, that is, it's easy to get in and easy to get out, and that is going to tend to inflate growth adds and inflate churn. Again, the net adds come out to the same place but you get -- that's how it affects those two metrics.

Deborah Crawford - *Netflix - VP - IR*

And, then, the second question, any initial impact you're seeing to churn based on the recent pricing changes?

Reed Hastings - *Netflix - CEO*

No, nothing material.

Deborah Crawford - *Netflix - VP - IR*

Next question is from Jason Cheu at ABR Investment Strategy. Generally speaking, what percent of new sub adds in the quarter were driven by Internet-connected video game consoles versus mobile devices such as smartphones and tablets? How important are these devices for your international expansion?

Reed Hastings - *Netflix - CEO*

Jason, we don't break out how -- which of those are driving our marketing, and I would say they're all important in international expansion, proportional really to the size of their installed base in a given country.

Deborah Crawford - *Netflix - VP - IR*

Couple questions from Daniel Ernst at Hudson Square Research. In your letter to investors, you discuss the desire to work with studios to have content cash outlays better matching expensing, which I presume would mean lower up-front cost and better scaling with usage and subscribers. Are there other examples in content licensing that you can model that plan after? On the flip side, TV syndication deals do require substantial up fronts. Therefore, what is the prospect for getting content owners to feed up front payments?

Reed Hastings - *Netflix - CEO*

Almost all of our deals, Daniel, right now match cash with expense and you see that in our cash flow for Q4. So, it's really just a question of each of the two sides' relative cost of capital and most of the studios and content owners they deal with have lower cost of capital than we do, so, it's not that hard an issue.

David Wells - *Netflix - CFO*

If I can add something, this is David. We have been able to get a number of deals where the payment terms are matching the expense, so, it's not like there's not a precedent out there. As you pointed out in the syndication market, we're evolving with that marketplace.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Deborah Crawford - Netflix - VP - IR

Next question is from Jason Helfstein at Oppenheimer & Company. In your comments you talk about the current \$7.99 per month plan, it's for one stream at a time, even though, today, the Company does not limit concurrent streams. Is there any data you can share about what percentage of the households run concurrent streams today? Secondly, if you were to think about family plan economics, what type of price points seem like a fair value to you?

Reed Hastings - Netflix - CEO

We don't have specifics of the number of concurrent streams, Jason. And, think of it as if there's one concurrent instance in a year, that subscriber, that household is unlikely to spend to get a separate account. There has to be pretty frequent conflict and so, it's not a how many concurrent incidences, it might be related to, for example, how many people have more than a multi-concurrent stream per week or something that will affect how well we can drive the evolution to individual accounts. And, when you talk about family economics, we'll test a range of scenarios and try to figure out the consumers' view of what's a fair and appropriate option. But, that will be in the second half of this year, at earliest, and may slip into 2012 before we get into that.

Deborah Crawford - Netflix - VP - IR

Next question from Steve Rubis at Stifel Nicolaus. Can you provide details on how many subscribers streamed your Watch Instantly during the quarter? Can you provide any details regarding Watch Instantly utilization in the Bay Area, as well as the rest of the country?

Reed Hastings - Netflix - CEO

We can tell you, Steve, it's continued to increase like it had in the prior quarters, there's been no real change in the trend and that it's great in the Bay Area, great in the rest of the country and, generally, streaming has continued its tremendous growth for us.

Deborah Crawford - Netflix - VP - IR

Next question, usually you provide the stock comp expense associated with several categories of the P&L. You did not provide this information this quarter. Are you changing your reporting policies and, if not, can you provide that data?

David Wells - Netflix - CFO

Steve, this is David. No, there's no cause for alarm. That information will be continued to report in the Q and the K in a footnote. It's just a matter of cleaning up the earnings release, trying to gain some real estate.

Deborah Crawford - Netflix - VP - IR

Next question is from Doug Anmuth at Barclays. How would you potentially implement the shift from a household service to that of an individual subscriber? Is there any data you can share with us on simultaneous streaming, and is this a good strategic thing to do in the face of potentially more streaming competition? What do you view as the core benefits to individual subscribers?



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Reed Hastings - Netflix - CEO

The question really is, Doug, is video naturally because of the portable devices, the laptops, the pads, the phones and individual relationship like e-mails and individual relationship or mobile phones and somewhat it is and somewhat it isn't because of the use of shared screens also. And, so, what we have to do is try some things with subscribers to see how comfortable that notion of a personal subscription really is and what are the advantages in terms of increased personalization that are Facebook integration a simpler relationship compared to the complexities of it. But, we would certainly like to, and we'll be working towards, having it evolve to be an individual relationship over time.

Deborah Crawford - Netflix - VP - IR

Next question from Doug. I understand the business of changing and realtime, but can you explain in more detail why you're not guiding for the full year?

Reed Hastings - Netflix - CEO

Well, I think, in general, we found our guidance from last year was so far off that I'm not sure it's very relevant. The business is moving so quickly, so, we did give some guidance for the year, that we expect net ads to continue to grow, and margin. But, how much it grows, I think from last year you can clearly see that we're not a distinguished authority, so that's really the reasoning behind it.

Deborah Crawford - Netflix - VP - IR

And, finally, from Doug, Canada, do you believe usage-based pricing among broadband providers in Canada is having any impact on Netflix subscriber counts or overall usage? Do people fully understand that they might need to pay more for broadband when using Netflix?

Reed Hastings - Netflix - CEO

It's something, Doug, we're definitely worried about, and my sense is that those Canadians with capped and \$1 or \$2 per gigabyte overage charges, many of them probably don't understand their plan and it will take a billing cycle or two for them. And that is potentially a significant negative for Netflix. And, the shame of it is, is that the marginal cost is, as we wrote in the letter, to deliver a marginal gigabyte over a wired network is extremely small, well less than a penny. So, hopefully, we can work with the different consumer groups and providers and get a better costing structure, where if there are pay per gigabyte charges, they're more than the one penny range or they're bundled in with a much higher cap like exists in the US and in many other nations.

Deborah Crawford - Netflix - VP - IR

Next question is from Edward Williams of BMO Capital Markets, another Canadian question. Regarding Canada, how long will it take to get to comparable penetration rates in Canada as compared to the US?

David Wells - Netflix - CFO

Doug, this is David. We don't talk specifics, but it's not hard to see from our guidance for Q1 that Canada is growing much faster than we did in the US. So, in terms of putting an actual number out there, I don't think we'd be willing to talk to that, but, suffice it to say is we're growing much faster in Canada than the US.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Deborah Crawford - Netflix - VP - IR

The next question is from Zachary Turnage at the Harbert Value Fund. Why did AP increase so much?

David Wells - Netflix - CFO

Zachary, sorry, was it from Zachary?

Deborah Crawford - Netflix - VP - IR

Yes.

David Wells - Netflix - CFO

Zachary, this is David. AP increased if you followed -- if you look at the balance sheet and the cash flow statement, you'll notice that we had a significant increase in the investment in our streaming content library, and, so, a couple of these were large payments that just were timing at the end of the quarter that should reverse themselves in Q1.

Deborah Crawford - Netflix - VP - IR

Next question is from Richard Greenfield at BTIG. As you move away from your DVD Buy Now business, what do you foresee as your greatest competitive advantage in streaming as we presume at some point competition will actually materialize, and it does not appear that the vast majority of your content is exclusive?

Reed Hastings - Netflix - CEO

Richard, it's Reed. I think our primary competitive advantage is the subscriber base, and that allows us to get more content on a fixed-cost basis to do more R&D, to market more, so there's a lot of virtuous cycles around the subscriber base size that we referred to in the letter. And, that's how I would look at the primary competitive advantages.

Deborah Crawford - Netflix - VP - IR

The next question is from Doug Mitchelson at Deutsche Bank Securities. Do you believe it will get harder to acquire incremental films and TV shows from major Hollywood studios? And, where are you in quantity today and where would you hope to be in a few years?

Reed Hastings - Netflix - CEO

Doug, no, it's not gotten harder, it's gotten easier as we pay more. Three, four years ago, when we couldn't pay much, it was very hard, and, now, because we've got significant dollars to spend, we've got people coming to us and that makes perfect sense. So, while we're feeling great about both our ability to make content owners a lot of money and to get deals done and continue to fill out and improve our selection.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Deborah Crawford - Netflix - VP - IR

Another question from Jason Helfstein at Oppenheimer. Do you think Netflix success is what is hurting Red Box? Are you willing to comment on what hurt consumer demand for their product in Q4 and does this make a Red Box partnership more or less likely?

Reed Hastings - Netflix - CEO

I'm pretty confident that our success is not what's hurting Red Box, because DVDs were barely up for us and I think for Red Box, it was up 30% or something. So, I think those are really unrelated issues. And, of course, our streaming content is not the newest DVD releases and that's what Red Box focuses on, is the newest DVD releases. But, I don't really have more to say than that about Red Box. You also asked, is a partnership more or less likely? I don't think it was ever that likely. We're super focused on streaming and unlimited streaming, they're focused on new release DVD and they do a great job at what they do.

Deborah Crawford - Netflix - VP - IR

Next question's from Steven Frankel at Dougherty. What's the timing on introducing the Facebook integration?

Reed Hastings - Netflix - CEO

We'll be rolling that out in phases over this year, sort of quarter by quarter and month by month it will get better and better and better.

Deborah Crawford - Netflix - VP - IR

And, second question from Steven Frankel, at 20 million subscribers and growing, you have the scale to compete head-to-head with the traditional pay TV services for first-run movies. As the studio deals with HBO and others expire, is it likely that Netflix competes for titles on an exclusive basis?

Reed Hastings - Netflix - CEO

It certainly is possible that we would compete on an exclusive basis. We're willing to do that if we have to but we think it could make more economic sense for us and pay television to share windows, conceptually each paying two-thirds and the studio getting one and a third of what they were getting in the past. So, we tend to try to look for deals like that to make the content owners more money and allow the other aggregators to pay a little less. But, we're basically very flexible and just trying to find good ways to expand the content.

Deborah Crawford - Netflix - VP - IR

From Michael Olson at Piper Jaffray. Where will most of the OpEx for international fall? Will it be in marketing for the Netflix brand that is less well known?

David Wells - Netflix - CFO

Mike, this is David. I'd say that you can roughly think -- what we said in the past is that each international investment is split largely between marketing and streaming content and that will hold in the future.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Deborah Crawford - Netflix - VP - IR

Next question is from Barton Crockett at Lazard regarding international expansion. When you look at countries to expand into, do you see any desirable countries with meaningful incumbent providers of online subscription streaming services that you'd have to compete with? How does competition and the risk of bruising battles factor into your choice of countries to enter?

Reed Hastings - Netflix - CEO

Well, Barton, as you would expect it's one of the factors. Typically, in the markets that are the biggest prize, there's already vigorous competition and, so, it's a tradeoff there. So, we'll try a variety of things over the years, both in markets that already have competitors, also in markets that don't of the type that you're describing. So, I'd say we tend to try to put our money in play where we think it's got the best chance of a big, sustainable return. And, as I mentioned earlier to Ingrid, there's a lot of factors that go into that.

Deborah Crawford - Netflix - VP - IR

The next question is from Jim Friedland at Cowen. Are you using AWS in Canada? Will you be able to use AWS in future international launches?

Reed Hastings - Netflix - CEO

Well, sure, AWS is very global already and we'll continue to use AWS.

Deborah Crawford - Netflix - VP - IR

Next question is from Ken Johnson, an individual investor. What is your perspective on international growth in non-English-speaking markets? Would Netflix consider licensing a significant amount of non-English content to streaming to countries like India and/or China, perhaps the Spanish-speaking world?

Reed Hastings - Netflix - CEO

Sure. We don't limit ourselves in terms of our circle of competence to English language content. In fact, we're a very big licensor of foreign content already for the US market and we feel very comfortable licensing content for a variety of cultures and tastes. And, really, it's our global process knowledge and our technology that's globally relevant. And, by technology, I mean both on the streaming side and on the merchandising or matching which people tend to like which titles.

Deborah Crawford - Netflix - VP - IR

Next question is from Scott Devitt at Morgan Stanley. We estimate Netflix domestic subs will surpass HBO in 2012. Ted Sarandos recently suggested that Netflix would aggressively bid for Warner Brothers content, when Warners' current arrangement with HBO expires in 2014. Given that HBO and Warner Brothers are owned by the same parent, a parent that has made several negative public comments about your business, could you explain the dynamics here and how it is possible that by bidding for the content you could either get it or force HBO to pay more for it?



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Reed Hastings - *Netflix - CEO*

Well, I'm not sure I agree on the negative comments aspect. The press makes a living out of blowing some things up and we're nearly a \$100 million a year customer for Warner Brothers and both of us would like to expand that, if it makes sense to. In terms of specifically bidding on Warner Brothers content, that may be advantageous for us, it maybe that we end up, again, doing a share where Warner Brothers makes more money than they would have otherwise and both HBO and us have content, it could be a range of options in that. So, it clearly -- they will make a strategic decision based upon the different interests of the different divisions, but they are quite comfortable having us bid on it. They're not trying to exclude us in any way.

Deborah Crawford - *Netflix - VP - IR*

The next question is from Tony Wible at Janney Montgomery Scott. Do you believe that the move to variable-based distribution costs, i.e., the FCC usage-basedD billing that has prompted some ISPs to consider tolling web service companies and the push to price content on a variable basis will fundamentally change the way Netflix prices or tiers its service?

Reed Hastings - *Netflix - CEO*

Well, Tony it's a risk, particularly if pay-for-gigabyte, pay-\$1-per-gigabyte-type models for ISPs took hold. And, so, we will be involved in that debate. And, again, since the costs of delivering a gigabyte are less than a penny and falling, we don't think it's terribly likely but we don't want to be asleep at the switch and just let it happen.

Deborah Crawford - *Netflix - VP - IR*

Second question from Tony. Do you expect Google, Amazon and/or Apple to be a more formidable competitor in 2011?

Reed Hastings - *Netflix - CEO*

Definitely there's a lot of firms including the ones you mentioned that could be more direct competitor with us. The Internet is creating a ton of opportunity for a lot of firms and there's all different models between the pay-per-view model for new releases, the ad supported model. So, there's a lot of different companies with different strengths. But, as you know, we've been through a lot of competition in the past. We view that as a natural part of the process, and we're just focused on building our business as best we can.

Deborah Crawford - *Netflix - VP - IR*

The next question is from John Blackledge at Credit Suisse. What was the decline in disc shipments per subscriber per month in Q4 on a year-over-year basis? I think in Q3, disc shipments were down 24% year-over-year. Just wondering if the declines were around the same level or accelerating?

David Wells - *Netflix - CFO*

John, we don't publish shipment information like that, so I'm not sure where you got the Q3 quote. What we said in the letter, and I'll remind you, is disc shipments did actually continue to grow, they just grew at a lower rate than we'd expected. And, going into the fourth quarter, we already knew that we were going to offer a price change and a new plan offering on a streaming-only plan starting in late November. There was some uncertainty around the take rate on that plan and how that would affect our disc shipments, and, so, we were a little bit conservative in terms of planning out the number of shipments and I think you see that reflected in lower shipments.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Deborah Crawford - Netflix - VP - IR

The next question is from Nat Schindler of BofA Merrill. The comment in the text about charging for multiple streams per account is somewhat confusing to me. Are you planning to only limit the \$7.99 plan to a single stream or expecting to limit all plans to a single stream at a time?

Reed Hastings - Netflix - CEO

Nat, both the \$9.99 one-out DVD and the \$7.99, are one stream at a time and the vast majority of subscribers are on one of those two plans. So you could think of it as the vast majority of subscribers are on a one-stream-at-a-time plan. So, as we develop models around upgrades and how do you get either multiple streams on an account or multiple accounts or sub accounts, those are the kinds of things that we'll be testing and evolving over the coming quarters.

Deborah Crawford - Netflix - VP - IR

The next question is from Justin Patterson at Morgan Keegan. With regards to your experience in Canada, how is it tracking versus your initial expectations? What's been your biggest challenge in the region? What lessons have you learned that you can take to additional international markets?

Reed Hastings - Netflix - CEO

Well, I think the main lesson we've learned is confidence in the model. We were really unclear as to how well an aggressively priced on-demand Internet service would work without all of the DVD and brand history. Could we get cost-efficient marketing and get subscribers to sign up? And, in fact, we've proven to ourselves that, at least within the conditions in Canada, that that is indeed very possible and we feel very happy with the growth. And, so, then we'll take on a little bit bigger challenge and we've learned mostly to have confidence in the model of on-demand streaming.

Deborah Crawford - Netflix - VP - IR

Next question is from Michael Pachter at Wedbush Securities. How long do you expect fixed-price content contracts to be offered? Do you foresee a migration to a cost-per-subscriber model, much as is used by the cable companies in dealing with content providers?

Reed Hastings - Netflix - CEO

Michael, that's a possibility but it's not very likely. I think what is happening is the contracts, some of the contracts are short, a year or two, and, so, you can think of fixed cost for a year or two, is really just a high-granularity variable contract based upon the size. And, so, I would guess it would go that way. We definitely agree with the model that as we grow bigger, any individual piece of content is more valuable to us and we'll end up paying more for it. But, I think the form will be upon renewals of shorter term deals.

Deborah Crawford - Netflix - VP - IR

Next question from Youssef Squali at Jefferies. Could you speak to net neutrality in Europe?

Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

Reed Hastings - Netflix - CEO

Youssef, net neutrality is a pretty strong concept in Europe, so, no significant risks there. The aspect of the open regional, no charges interchange, however, is less strongly accepted and that's probably the big issue which is, can ISPs charge content providers like YouTube and Netflix and Amazon a significant fee to serve their customers, and, so, that's probably where the interest and the friction will be.

Deborah Crawford - Netflix - VP - IR

Great. Next, question from Peter Treadway at EMS capital. What do you think the operating margin potential of the Company is at maturity? How do you think about the range of outcomes?

Reed Hastings - Netflix - CEO

Peter, in prior calls, what I've said is the long term, i.e., the maturity operating margins, in an industry are really determined by the number of competitors. So, if there's three or four roughly equal sized competitors at maturity, you'd expect pretty low operating margins. If there's one firm that's the leading firm in the market, you'd expect higher operating margins. So, it really depends upon the competitive climate as opposed to something inherent in the cost structure.

Deborah Crawford - Netflix - VP - IR

The next question is from Andy Hargreaves at Pacific Crest Securities. As your subscriber base grows and subs stream more content, are you concerned about running into the limits of total bandwidth availability in a given geography?

Reed Hastings - Netflix - CEO

Oh, gosh, not at all. We recently did a calculation about fiber optics and what we discovered is that a single fiber optic, about the size of a human hair, because of the advances in dense wave-division multiplexing, can now carry all 100% of the Netflix traffic. So, if we had a single data center where all of the bits came out of, it could comfortably go out in a single fiber. And, furthermore, the improvements in the next three years expected in fiber optics are increasing that number. So, I would say the rate of innovation in data transmission, especially on fiber, is greatly outstripping any growth that we could possibly get to.

Deborah Crawford - Netflix - VP - IR

Next question is a follow-up question from Brian Fitzgerald at UBS, following up on the declining disc shipment question. In the letter you say that you expect disc shipments to decline year over year in the coming quarters. Is this the first time you've pointed to this? Did you move this inflection point forward?

David Wells - Netflix - CFO

Brian, this is David. Yes, it is the first time that we've talked about this and it's largely a function of plan mix, the streaming offer, streaming-only plan offering and just the embrace of the streaming-only offering service in general.

Deborah Crawford - Netflix - VP - IR

Okay, that's the last question I have. We'd like to thank everyone for your time and we look forward to talking to you again next quarter.



Jan. 26. 2011 / 11:00PM, NFLX - Q4 2010 Netflix Earnings Conference Call

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