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NFLX - Q2 2011 Netflix Inc Earnings Conference Call

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CORPORATE PARTICIPANTS

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David Wells
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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Netflix second-quarter earnings Q&A session conference call. During today's call, all phone participants will be in a listen-only mode. (Operator Instructions). As a reminder, today's conference call is being recorded. Now, I would like to pass the call over to Ellie Mertz, Vice President of Finance and Investor Relations.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Thank you, and good afternoon. Welcome to the Netflix second-quarter 2011 earnings Q&A session. I am joined here by Reed Hastings, CEO, and David Wells, CFO. We announced our financial results for the second quarter at approximately 1.05 PM Pacific time today. The shareholder letter and the Q2 financial results, and the webcast of this Q&A session are all available at the Company's Investor Relations website at www.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 18, 2011. A rebroadcast of this Q&A session will be available at the Netflix website after 6.00 PM Pacific time today. Now, let's move directly to questions. Similar to last quarter, we have organized the questions by topic as we've received them via e-mail this afternoon. We'll start with questions about the pricing changes we announced just two weeks ago.

QUESTIONS AND ANSWERS

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

How are you feeling about the price increase two weeks since announcing it? Do you expect for some of the subscribers turning off with the pricing increase, that they will return later, once they try other alternatives?

Reed Hastings - *Netflix Inc - CEO*

This is Reed. Like any customer-driven organization, we feel bad about having customers upset with us, but we feel great about the amazing new content we're going to be able to license in the fourth quarter and next year, which will further propel our growth and our subscriber satisfaction. The price change takes effect upon each subscriber's renewal in September, so we don't have a full-range view of it. But so far, from what we've seen, we've been very pleased at the effects, and we're feeling great about the decision, as tough as it is. And it's going to allow us to have just fantastic streaming content going forward.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Let me follow up on that. While still early, could you help us understand the initial effects of the subscription plan pricing change, so the net effect on subscriber growth, churn and ARPU?

Reed Hastings - *Netflix Inc - CEO*

Because of the timing, we announced it at the very beginning of a quarter, we'll see the negative effects of it in Q3. That is, the elevated churn and lower revenue growth than we would otherwise have. Then the price increase takes effect, essentially mid-September, on average. So we get a little bit of benefit at the end of the quarter, and then the real benefit comes in the following quarters, Q4 and beyond. But in terms of tracking where we are and our expectations, we're feeling very good.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Can you tell us what percentage of subscribers have cancelled the service? Have you seen subscribers migrate more toward the unlimited streaming plans or towards the DVD plans, or are they opting for both?

Reed Hastings - *Netflix Inc - CEO*

Well, we're making estimates for the end of the quarter. That's what's in our guidance. And we'll see over time what the split is. We feel great when you think about it, with our DVD service at $7.99. It's an incredible value. It's the lowest-priced offer in the marketplace. It's the best service levels in the marketplace. So if a customer wants DVD rental by mail, we're definitely the place to go.

And then in terms of streaming, we've gained increasing confidence over the last two years about the viability and strength of a pure streaming plan. We gained some confidence when we launched in Canada, and that blew away our expectations with the response. We gained some confidence when we led on our non-member home page with streaming only, and as we put in our shareholder letter, in Q2, about 75% of subscribers chose streaming-only. In other words, even though DVD was only $2 more, 75% stuck with streaming only. And again, with this pricing change, we're going to be able to strengthen that streaming plan with more content. So that's why we feel good about it.

David Wells - *Netflix Inc - CFO*

I'd say just to add on to that, our guidance in the letter shows people the strength of the offerings, in the sense that we do feel that most people are taking the hybrid offering. A lot of those hybrid subscribers are staying on both plans, and that's implied in both the guidance and the diagram that we put into the letter.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

So a follow-up question on timing. Why did you implement the recent pricing changes now, when subscriber growth is near the highest you've ever had? Why not wait until you are further into your penetration curve?

Reed Hastings - *Netflix Inc - CEO*

Well, I think the reason we felt confident about doing it now, is the strength of streaming-only, really we got convinced that we can thrive on streaming-only and with the great new content we're going to be able to get with this pricing change, the timing, the best timing was now.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Why did you decide to push through such a large pricing increase, versus a smaller, less disruptive one?

Reed Hastings - *Netflix Inc - CEO*

We didn't approach it as what percent price increase should one do, and I think if we had, we probably wouldn't have gone to 60%. So I can understand the question. We really approached it on that we should separate the businesses and the plans, because streaming-only was going to become a global offering, and we wanted to really focus on that global streaming offering, and DVD is an incredible US-based plan that's very profitable. It's very large, and we wanted it to be able to be successful and to have a group that was going to focus on it. And the pricing change, somewhat, was an outcome of that.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Okay. Why lower the price on DVD-only? As some shift to streaming the economics of the remaining DVD business would appear to be working against you. Is there a lot less infrastructure for less subs?

Reed Hastings - *Netflix Inc - CEO*

We didn't lower the price on DVD-only. We never had a DVD-only plan. So the perception of lowering might come from the combination plan which was $9.99, and it was the only way to get DVD, and for someone who is very rural and doesn't have broadband, they were essentially paying that extra $2 for streaming, not being able to access it, and so we felt great about making a low price -- aggressively low-priced $7.99 DVD plan, and that that was the right plan to carry forward on our DVD side.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Could you explain in more detail the thought process and drivers behind separating the DVD-only business, the start of DVD-only marketing again, and looking to improve the service after several quarters of effectively putting that part of your service back-of-mind?

Reed Hastings - *Netflix Inc - CEO*

One of the aspects that we wanted to get is that the DVD can last a long time as a successful service, and generate lots of satisfaction and lots of profits, if we give it a platform to succeed on. And it is true that we haven't marketed it much in the last couple of years, but by now, having it as a division within Netflix, we've got a way to measure the P&L, and we think it will be a smart investment in its growth and sustainability. And whether -- growth is probably a bit overstated. That would be an aggressive case. But at least that it will shrink slowly, as opposed to rapidly with a little bit of investment, and we'll figure that out over the next couple quarters.

David Wells - *Netflix Inc - CFO*

I think we've always talked about the DVD side of our business in a spectrum of emphasis and focus, and rather than being pushed to the extremes, what we've said is that we focused on streaming. We've proved it out. We've had two to three quarters of tremendous growth, and now it's the right time to go back and look at how easy is it to find the DVD service, how easy is it for those subscribers to find what interests them, and that's what I think, this is a step in that progression.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Does the separation of streaming and DVD plans set the stage for the acquisition of streaming content on a per-subscriber basis?

Reed Hastings - *Netflix Inc - CEO*

No, there's no connection between those issues.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Can you please give us a little bit more color on your Q3 guidance? I was hoping to hear your thoughts on US subscribers. Are you expecting significant cancellations with the new price plans? Are we close to the peak number of subscribers Netflix reasonably hopes to attain in the US?

David Wells - *Netflix Inc - CFO*

I think we've answered most of that question in the sense that we've provided pretty clear guidance in addition to providing some streaming versus DVD subscriber guidance. I don't think there's any implication that we're nearing the peak in that, and I think that we are expecting Q3 to be a quarter where we have subscribers choosing where they want to land, and then Q4, we expect to return to growth, as the comments in the letter indicate.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Netflix prides itself on customer service. Did the call volume after the price change surprise you at all? Calls were actually being disconnected instantaneously. And what about the social media reaction? Was the noise level in-line or higher than you expected?

Reed Hastings - *Netflix Inc - CEO*

Believe it or not, the noise level was actually less than we expected, given a 60% price increase for some subscribers, so we knew what we were getting into. We tried to be as straightforward as we could, and that has worked out very well for us. In terms of the customer support line, it was very short amount of time that it exceeded our capacity there, and now our service levels have returned to our normal great service levels.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

How does separating your DVD and streaming business impact your relationships with the studios? Do you expect the content partnerships to be negotiated separately in the future? What kind of impact does that have?

Reed Hastings - *Netflix Inc - CEO*

The content acquisition has mostly been separated for a while. That is, movie studios mostly have different divisions between DVD and streaming. And then the television studios very much have been different for a while. So we don't see any significant effect coming out of the separation of the plans.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Let's move to questions about content. Could the Company please address what proportion of total streaming content is obtained under revenue-sharing agreements, along with color as to what types of titles are usually obtained under such arrangements, and how the economics of revenue-sharing compares to the Company's other content purchasing agreements?

Reed Hastings - *Netflix Inc - CEO*

For streaming content, we buy like our industry and pay television and network TV buys and cable networks, which is you have to commit upfront, and you have to pay a fixed amount per time period, typically per year, for access to that content on your network. So that's the industry in which we compete and we buy in that way. So there's not revenue sharing in the DVD-style model. And of course on DVD, we have some revenue sharing, and that's as it always has been.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Sony Pictures Films are still down for the Netflix service. Could you go directly to Sony and Disney for streaming content, or is the Sony Starz agreement exclusive until 2016, 2017?

Reed Hastings - *Netflix Inc - CEO*

The Starz agreement and that industry, for example, HBO, also are exclusive. So it's working through Starz, that is our preferred option.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

In the shareholder letter you noted that streaming content deals are, quote, being recognized as assets on our balance sheet, unquote, as the content becomes available to streaming customers. How, if at all, does this affect the former $1.6 billion of commitments related to streaming content license agreements that do not meet the content library recognition criteria? Is this how those commitments move onto the balance sheet, and in that case, how are the assets matched on the liability side of the equation?

David Wells - *Netflix Inc - CFO*

That was a pretty long question, but in general, that is how the staging area for content contracts as they move into what we call in-window, or available for streaming. When they do that, depending on the payment terms on the matching side, there will be cash out for quarter of payment. The quarter of expense associated with that, and then to the extent that there's short-term liabilities, it will move into accounts payable. That's one of the reasons that we discussed that in the letter. And if they're longer than a year, it will increase accrued, the other accrued liabilities. At this point I'll take those questions and sort of refer you to our IR website. There's a pretty detailed treatment of our content accounting, and it should walk you through exactly what happens under each scenario.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Could the Company please address; one, what is the total content obligations as reflected in the content -- excuse me, in the contractual obligation footnote of the 10-Q outstanding as of 6/30/2011, and what amount of content obligations are due within the next 12 months?

David Wells - *Netflix Inc - CFO*

Sure, this will fall within the next few days as we file the Q, but right now, there's $2.44 billion in that contractual obligations versus $1.84 billion in last quarter as of 3/30. And roughly a quarter, or about $625 million of those, are related to short-term.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Do you find that demand for streaming titles fades after their streaming debut, or does the demand remain constant over the life of the content availability?

Reed Hastings - *Netflix Inc - CEO*

It's very title-specific. So we're very excited about launching Mad Men in a few days, and being the exclusive subscription provider of that content. And what we expect to see is a burst of activity, and then it will slow a little bit, and then there will be another burst as season five goes live on television, and consumers want to go back to seasons one through four to get into the story, so it gets built by that outside promotion. So there's a lot of patterns in that way. But in general, we've been very pleased with continuous viewing that we've seen on, when we license content, that it doesn't die right away and in fact has a great life.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Bloomberg and other outlets have said Netflix is in discussions with DreamWorks Animation for a streaming deal. Can you comment on those reports, or generally on the potential to take away studio output deals from HBO and other premium services? Should we see a potential deal with DreamWorks as a potential hedge on the risk of not renewing with Starz and thus leaving access to Disney's family movies?

Reed Hastings - *Netflix Inc - CEO*

We're always in talks with all of the different providers in terms of licensing more content, but we're not going to comment on them in advance. If we conclude a deal, we would typically announce it and go forward on that basis.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

We're going to move now to questions on our international expansion. A lot of us on the sell side thought that the Latin American rollout would maybe be just one or two countries at first, followed by an additional one to two countries six months later, after you have climbed the learning curve. Instead, it's 43 countries simultaneously. What's your reaction to the notion that you guys are biting off more than you can chew? Why not focus on the largest countries first? Why spread marketing dollars so widely?

Reed Hastings - *Netflix Inc - CEO*

I think that's driven by, internally, some balance between moving too fast and too slow. So you could make the argument that we should just focus on Brazil, say, and learn some lessons there, before expanding to the rest of Latin America. Or you could make the argument, no, we should go even faster, and we should do Asia and Europe and South America all at the same time. And we ended up in the middle, of doing Latin America, all the countries at the same time.

Our primary focus is on the larger countries, in terms of where we spend on the marketing, but most of the content deals are Latin America-wide. So it's inefficient to arbitrarily not allow the service to be in certain countries, when we've essentially paid for the content in those countries anyway, so that's where we get to. But we're definitely focused most of our time and effort on the major countries.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Can you offer us a little color on your progress with signing local content? What will be the local versus American content mix available to consumers in these new countries? Have you been able to secure such local language programming at reasonable rates?

Reed Hastings - *Netflix Inc - CEO*

As we get closer to launch, we'll have more content to announce. Obviously, in Latin America, there's lots of watching of sports, which we're not going to be carrying. There's lots of watching of Hollywood films, which we'll have. And there's lots of viewing of telenovelas and we'll have a very nice complement of telenovelas for launch.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

What level of streaming content is necessary to launch markets in Latin America? Do you believe it to be more or less than Canada, either from a dollar or title perspective?

Reed Hastings - *Netflix Inc - CEO*

Well, we're going to launch with much more content than we did proportionally in Canada. And that's because we're more confident of the outcome which is part of what we learned in Canada. We started Canada pretty cautiously, and then quickly built up the content, and we have more confidence, and so we're starting even stronger in relative terms in Latin America than we did in Canada.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Your guidance for international subscribers seems to suggest that you expect slower subscriber growth in Latin America compared to what happened in Canada. Do you expect adoption rates in Latin America similar to what you experienced in Canada?

Reed Hastings - *Netflix Inc - CEO*

No, that would be too aggressive. Canada is consistently rich, as opposed to pockets of wealth, and Canada is broader in broadband, has more broadband penetration per capita, and it also has more video game consoles per capita. So on a per capita basis, it will be slower than Canada. On a per broadband household, it will still be slower, because of payment methods and because of video game consoles, but still, we're very optimistic about what we can create, and what will happen in Latin America.

David Wells - *Netflix Inc - CFO*

The only thing I'd add to that is -- Reed mentioned that the major reasons. There's a small brand halo effect in Canada that we don't have down in Latin America, as you would imagine. So we're building a brand that is largely unknown down in Latin America, so there's a little bit of an effect there in terms of the speed.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

So moving to questions specifically about Canada. What feedback have you gotten from Canadian subscribers about the data plans? Has the subscriber growth number been materially affected by the data plans?

Reed Hastings - *Netflix Inc - CEO*

We don't think that the subscriber growth number is materially affected by the data plans, post our shift a few months ago to default people to the lower data plan, which is a very efficient use of data. So the primary things that we're learning in Canada is that it operates from a seasonality basis, a little bit like Alaska, which is that summertime is great. People are outdoors and watching less content and wintertime is cold and dark, and people watch a lot of content. So in the US, we see more seasonality in Maine and in Alaska than we do, for example, in the rest of the country. And Canada's operating consistent with that increased seasonality.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

So based on that, how would you expect that adds in Canada could trend year-over-year in, say, Q3 and Q4?

David Wells - *Netflix Inc - CFO*

Well, I'd say in Q3 we had a large, pent-up launch and so it will be difficult for us to match that comp. I wouldn't add anything other to the guidance that we've already provided in terms of international subs.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Moving to questions about competition. How has Amazon's deal for CBS content changed the landscape for acquiring content? How, specifically, will Netflix change its strategy, if at all?

Reed Hastings - *Netflix Inc - CEO*

It hasn't changed. That deal hasn't changed our perspective. Our brand is strong and focused, and that's what we're continuing to invest in and improve. And we haven't been able to detect any effect from the Amazon Prime bundling.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

What most concerns you about competitive streaming services? Have you seen much traction for Amazon's service or HBO Go that is creating a compelling alternative experience for Netflix subscribers?

Reed Hastings - *Netflix Inc - CEO*

We haven't seen anything that's an alternative service. HBO Go's a very impressive application, it doesn't have any of the content that we have, and we don't have any of the content that it has. So again, it comes back to my metaphor of baseball and football competing for some of the same dollars and time, but really different offerings.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

All right. Let's move to questions about subscriber metrics. As it relates to the current churn rate, could you please provide some numbers on what percent or number of your current customers are repeat customers, meaning they have had the service in the past, cancelled and then signed back up?

David Wells - *Netflix Inc - CFO*

What we have said in the past is it's about a third in terms of rejoin rate. Obviously, the price changes have had a small effect on that and we're waiting for the trend to revert to a new level. But I would say that the effect on the rejoin rate was not more than 20%, in terms of that trend.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

As we prepare for Netflix to provide less information about subscriber growth and churn, it would be helpful to understand the retention levels for customers based on their tenure with Netflix. Do you see different rates of retention or churn for customers, depending on how long they have subscribed to the service? Are longer-tenured subscribers retained on a higher or lower rate than subscribers that have used the service for a year or less?

Reed Hastings - *Netflix Inc - CEO*

All subscriber services have the aspect that the longer a subscriber has been with that service as a class, they're preselected to either be comfortable with -- really comfortable with the value proposition, and churn declines with age continuously. I'm sure that's the same on all subscription services, and it's certainly true for Netflix. But mostly what we focus on is net adds. It's very easy to get distracted by sac and churn in our experience, and we focus on how's our net add growth compared to following prior year period and compared to other aspects of the service.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

So one more follow-up question on churn. Is there a material difference in churn between streaming-only customers and a streaming-plus DVD hybrid customer?

Reed Hastings - *Netflix Inc - CEO*

Yes, as we've said before, the streaming-only is higher churn. It's a less of a commitment than those who have taken DVDs and the DVDs are at home in that way. So it's also easier to sign up, because you can use the service 10 minutes later as opposed to wait for the DVD. So you get easier to sign up, more cancels, but again, if you look at the net adds, they're very positive, and we just want a lot of people to try Netflix. If they don't currently have the budget to keep it, that's okay. They will over time. So we're really fine with lots of people trying Netflix and being exposed to that.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Let's move to questions about the financial results. You had a large sequential spend increase in tech and dev and G&A, while historically, you have had very moderate moves from Q1 to Q2 in these expense lines. What's specific new investments are you making, and will these expenses continue to grow at a similar pace going forward?

Reed Hastings - *Netflix Inc - CEO*

I'll take them separately. Tech and dev is generally headcount growth associated with both our domestic and our international investments. There's some partner spending in there as well, but it's mostly dominated by headcount, and as a percent of revenue it didn't actually grow. So it grew sequentially but in terms of percent of revenues, it's still about 7% of revenue. I would expect that line to continue to track as we invest further, in terms of percent of revenues. In terms of G&A, that should scale more slowly, but we did have a $5 million commercial settlement charge in the quarter that was a one-time charge that you normally wouldn't see in the quarter.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Given your relatively modest cash position, relative to the size of checks you're writing for content, and the success you're having with that content investment, what is the rationale of buying back stock? Given the multiple you get for subs, wouldn't you generate more value by investing in adding subs versus buybacks?

David Wells - *Netflix Inc - CFO*

We think about that slightly differently in the sense that our marketing expense is not constrained by how much cash we have in the bank. Our marketing expense is constrained by two things. One, how much marginal cost or marginal subscriber acquisition cost we'll have to lay out to acquire that subscriber, and can we do that at a profitable level. And then the second constraint on our marketing expense is basically our earnings targets that we set for us.

So we have three legs, basically, of investment. One is our streaming content investment. One is our marketing. And one is our earnings target, basically putting money towards -- back to investors. And setting that 14% operating margin -- domestic operating margin target allows us to set basically a content spend and a marketing spend. And so how we think about cash relative to the buyback is independent of how much we spend on marketing. And I'd say how we approach the buyback is what could we do with that cash as an alternative use? Should we hold it as an insurance policy, or should we return it to shareholders and a buyback is the most efficient way to do that.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

In Q4 2011, you say that growth in net subs will resume. Is it fair to assume that the improved year-over-year trend is driven by a return in cancellation rates to normal levels? In other words, you see the price change as stimulating only a one-quarter hiccup in cancellation rates?

Reed Hastings - *Netflix Inc - CEO*

Yes, basically. What's happening is in Q3, there's an increase in cancellation because of the price increase announcement, and taking effect. And in Q4, we expect the more typical year-over-year trend of net adds growth to return.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

You had guided that Q2 2011 gross margins would step down versus the first quarter and it didn't happen. You're essentially saying the same thing for the second half of 2011 versus the first half. Why should we believe you? Have you already signed online content deals that would cause a gross margin step-down in the second half of the year, or would you need to sign new deals to hit your guidance for a step-down?

Reed Hastings - *Netflix Inc - CEO*

We have to sign new deals to get there, so we believe that we will find that content on the right terms, and so that's why we're saying that. But it's definitely possible that it will be like in the past, where we under spend slightly on the content side. But we definitely want the flexibility to be able to spend to that, and thus our statements.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

As we think about 2012, how should we think about your domestic operating margin target? In 2010, it was around 12% plus. In 2011, it is 14%. So you've exceeded it in two quarters in a row. Should we consider the 14% operating income target a long-term target or a near term target?

David Wells - *Netflix Inc - CFO*

I think you should consider that a target that we're comfortable with for 2011, and as the year progresses and as we know more about how our DVD division does and our streaming offerings do, we'll probably look to raise that target going forward, slightly. But it's all relative to our international investments and our domestic investments, both DVD and streaming.

Reed Hastings - *Netflix Inc - CEO*

I would say that's been a multi-year pattern. We were at 10% three or four years ago, so you see our value system in terms of allocating profits and growth, and as we continue to grow, also increasing the operating margins.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

At maturity, is there any reason to think the margins in the US and international streaming businesses will be materially different?

Reed Hastings - *Netflix Inc - CEO*

I think the operating margins are really most closely linked to the competitiveness in the market. So if, in a given country, we've got five big direct competitors, I would expect the operating margins in that territory to be less than in another market, where we have a fewer number of significant competitors. So it really depends on, ultimately, on the number of competitors. That's what drives the operating margins.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

A question on the balance sheet. What happened to current payables and other non-current liabilities? They exploded during the quarter.

David Wells - *Netflix Inc - CFO*

Well, I think I addressed that earlier, but basically as we have these large content, multi-year content streaming agreements come into window, or available for streaming, they're recognized as an asset. They come into the content library, and depending on the payment terms, there's associated accounts payable increases or other accrued which in the -- it's longer than a year in terms of the payable.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Moving to a handful of miscellaneous questions. There have been several service disruptions to the instant-watch service over the past quarter. Could you please characterize the nature of these disruptions, and indicate what can be done or has been done to reduce or eliminate them going forward?

Reed Hastings - *Netflix Inc - CEO*

Well, we're working very hard and expanding our systems to be able to handle the growth in capacity and we think we're making great improvements in those, and so we're very focused on improving that.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Can you explain the domestic Facebook issue? Consumers are already sharing a lot of broadcast and cable network viewing data on Facebook and Twitter. Why should Netflix be viewed differently, as long as it opts in?

Reed Hastings - *Netflix Inc - CEO*

Unfortunately, Judge Bork, when he went for Supreme Court nomination, some enterprising reporter got his video rental records from a local video store, and in the next few days, Congress passed an Act, perhaps propelled by every Congressman's fear of their own video rental records being released. And so it passed so quickly that it was fairly poorly drafted and it's very ambiguous what happens, and who it applies to, does it only apply to people who rent DVDs or is it more broad than that? Does it apply -- can a consumer get permission? So it's that ambiguity that leads us to want to seek this clarification, and that's why it's different.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Does Netflix still plan to launch family plans, or is it something that you're still thinking about?

Reed Hastings - *Netflix Inc - CEO*

We don't have any specific plans to launch family plans. We do have an interest, as we said, over the next few years, in figuring out individual accounts and making Netflix feel more personal to the individual. We've got a couple of building blocks in that, including the Facebook integration. So that's not going to happen in the very short term, but it's consistent with what we said before, which is it's something we're working on over the next few years.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Moving to the final topic, DVD. Overall, does DVD become more or less of a priority, now that the service has been decoupled from streaming? Will the DVD business start to decline faster than anticipated? Any color here would be appreciated.

Reed Hastings - *Netflix Inc - CEO*

It will become less important to those people at Netflix working on streaming, and much more important to those people in the dedicated DVD division. And that's the purpose of putting it in a separate group, so that they can focus on that. In terms of the long-term decline rate, it's hard to know. If you look at the music industry starting in 2000, then it was around 10% per year, so that might be a proxy, but it is hard to know. What we do know is that we're going to maximize whatever opportunity is there. And that's why we've got a dedicated group, who actually have come up with some pretty neat ideas for how to improve the DVD service, which will be -- and those improvements will roll out in Q4.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

What will the key performance metrics be for the standalone DVD business? Will there be an increased focus on near-term profit and cash flow as opposed to subscriber growth?

David Wells - *Netflix Inc - CFO*

I don't think there will be an increased focus. That part of our business will still be revenue, operating profit, specifically operating profit, and trying to maintain or grow that profit if they can. So I wouldn't characterize it as an increased focus. I'd say it's about the same as we've had before.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

You mentioned that you'll begin marketing the DVD business again in the fall. Is this incremental sac cost on top of the streaming service cost, or do you feel that the streaming service is established enough to pull back somewhat on your spending there?

Reed Hastings - *Netflix Inc - CEO*

It's not really either. We're focused on backing the DVD service, and then we'll see what happens. We'll see how effective that marketing spend is, and learn and adjust from there. What we wanted to do is make clear that we think DVD has a longer and bigger life than many people otherwise think, and that we're prepared to do some investment to see that thesis through.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Can you tell us what type of improvements we can expect from this division going forward?

Reed Hastings - *Netflix Inc - CEO*

No, we'll be announcing those in Q4.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Final question. Will you now be breaking out streaming and DVD segments separately in your financials to give us a better understanding of the transformation, or does this replace the domestic and international segments?

David Wells - *Netflix Inc - CFO*

I think we addressed that in the letter, but just as a repeat, what you'll see from us is in the Q4, by Q4, we will have enough information so that we're looking at our business in the different segments. So in the January filings, you'll see a segment oriented around DVD and a segment around streaming. And we've also provided additional information in our guidance this quarter for Q3, and you'll see that again in October for Q4.

Ellie Mertz - *Netflix Inc - VP - Finance, IR*

Okay. That's the last question for today. We would like to thank everyone for your time, and we look forward to speaking to you again next quarter.

Operator

Ladies and gentlemen, thank you for joining today's conference. This does conclude the program and you may now disconnect.