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EDITED TRANSCRIPT

NFLX - Q1 2014 Netflix, Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

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Reed Hastings *Netflix, Inc. - CEO*

Ted Sarandos *Netflix, Inc. - Chief Content Officer*

CONFERENCE CALL PARTICIPANTS

Rich Greenfield *BTIG Research - Analyst*

Doug Anmuth *JPMorgan - Analyst*

PRESENTATION

David Wells - *Netflix, Inc. - CFO*

Hi. I'm David Wells, CFO of Netflix, and I'd like to welcome everyone to today's Q1 2014 earnings interview. I'm joined today on the Company side by Reed Hastings, CEO, and Ted Sarandos, Chief Content Officer. Interviewing us will be Rich Greenfield of BTIG Research and Doug Anmuth of JPMorgan.

We'll be making forward-looking statements in today's earnings interview. Actual results may vary. At this point, I'd like to turn it over to Rich Greenfield for our first question.

QUESTIONS AND ANSWERS

Rich Greenfield - *BTIG Research - Analyst*

Thanks, David, and thank you to Reed and Ted as well, for having both Doug and myself co-moderate your Q1 earnings conference call. I think we're going to go back and forth, and switch between Doug and myself asking questions.

The first question we'd like to address to Reed Hastings. The question that I think is on everyone's mind right now is: Why is now the right time for a price increase? I know, a few years ago, you had talked about the need to wait a few years to raise pricing. Is it merely that a few years has passed, or is there something else driving the need to raise pricing?

And then attached to that, how should people think about the flow-through of the revenue you're going to generate from that higher price increase? Will that be reinvested in content, or should we expect all of that to drop to the bottom line?

Reed Hastings - *Netflix, Inc. - CEO*

Rich, over the last couple of years, we've been improving the content selection on Netflix and broadening it. Most recently, with the addition of the amazing shows like House of Cards and Orange Is the New Black.

And if we want to continue to expand, to do more great original content, more series, more movies, we have to eventually increase prices a little bit. We're not doing much, we're doing $1 or $2, depending on the country, and all the existing subscribers keep their current price. They don't get an increase.

So, therefore, the revenue increase to Netflix will be quite modest in the short term. And eventually, as new members come in, they pay a little bit more, and with that, we'll be able to license much more content and deliver it in very high-quality video.

Doug Anmuth - *JPMorgan - Analyst*

And Reed, would you still think about tiering going forward, or does this potentially remove that possibility over time?

Reed Hastings - *Netflix, Inc. - CEO*

No, that's definitely a possibility. We're continuing to look at that. So, this is the -- the big focus is on this increase, and we want to get this done well, and make sure we grandfather people cleanly, and it's something we're definitely looking at.

Doug Anmuth - *JPMorgan - Analyst*

But you still believe a tiered structure over time is possible. What are the things that you could potentially tier on: concurrent streams, standard def, high def, number of devices, content? How do you think about that?

Reed Hastings - *Netflix, Inc. - CEO*

We have tiering now. We have two plans. We have the two stream at a time; that's $7.99. And we have the four stream at a time, which is $11.99. We have tiering today, and it's definitely something we're thinking about, in terms of expanding the options that people -- that consumers have, some of it being on the criteria that you referred to.

Rich Greenfield - *BTIG Research - Analyst*

Is the two-year, Reed, that you talked about, in Ireland for grandfathering, is that what you deem generous, as you think about how to properly support the current subscriber base that you have with the price increase? And how will you actually communicate the risk to a consumer of dropping out and then being tagged with a higher price if they choose to come back?

Reed Hastings - *Netflix, Inc. - CEO*

You're talking about a $1 or $2 difference per month, so I don't think it's a huge difference. And then, yes, the two-year is very generous. We'll do between a year and two. We're still looking [at kind] of that, so we'll be able to announce more details later.

Doug Anmuth - *JPMorgan - Analyst*

And, David, how would you think about how you would reinvest the dollars from the price increase, into additional content, or allowing that to fall more down to the bottom line?

David Wells - *Netflix, Inc. - CFO*

Well, Doug, we've said before that mostly it's going to be towards content. It's about improving our service. If you think about generous grandfathering, that's going to bleed in over time in terms of the average subscription price. It will take a while; I think it will be gradual.

At the point where we reach 30%, where we think is coming up, we'll look at the Business and make the right long-term choices for both profitability as well as a long-term profitability, which you get from a very strong consumer offering, which means content as well.

Rich Greenfield - *BTIG Research - Analyst*

David, I think actually on the last conference call, Reed had talked about, as you get to the 30% domestic contribution margin, it would get tougher to expand by 400 basis points a quarter. Does the price increase -- doing it now -- actually change that forecast? Is it easier to add 400 basis points to margins domestically in both 2015, 2016 and beyond?

David Wells - *Netflix, Inc. - CFO*

Well, so, adding revenue makes it, by nature, easier. But what he's referring to is the fact that the numbers get larger, right? That margin is a percent of revenue; so, as that number gets larger and larger, it gets harder and harder to add 100 basis points, or 400 year on year. So, I don't think it changes anything in the calculus. When we say that when we reach 30% we'll look at the situation, we'll look at the Company and make the right, smart, long-term choices, including how much we put to content, how much we put in terms of streaming delivery and product, how much to marketing, and then how much to profit.

Rich Greenfield - *BTIG Research - Analyst*

And, Ted, do you want to talk for a minute about the new content and some of the things, at least in the general, that we'll be able to do post the price increase?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Yes, I mean, we're rapidly expanding our original production. We have several productions running today, all around the world. And I think when you look at the size and scope, and the ambition level of some of these projects, you'll see that this is a great time for consumers, because people who were never working in television before are thrilled to be working in television today, and doing some of the best work of their life. At higher budgets, sure; but that's a good thing for everybody, including us, because we're in the position to be able to bring that kind of production level to our members.

Doug Anmuth - *JPMorgan - Analyst*

David, the comment about international profitability from existing markets expected by the end of the year -- is it fair to assume that the UK is profitable now, with Latin America still experiencing losses?

David Wells - *Netflix, Inc. - CFO*

We didn't say anything specifically about individual markets. I think what we've said, and we'd reiterate, is that each market has gotten better, has been growing, and has been improving in terms of a loss, but we didn't give any specifics about it. We wanted to give that comment about our overall profitability of all of our existing markets, to demonstrate that before we launch another substantial expansion, that we're pretty confident in our existing performance in the markets we have today.

Reed Hastings - *Netflix, Inc. - CEO*

And, Doug, I'd add that we're very confident of our success in Latin America, as well as the UK. So, we're making great progress in every country, which is giving us a big ambition for this next round of European expansion.

Rich Greenfield - *BTIG Research - Analyst*

A question for David, though, to follow up. When you look at that $300 million to $400 million, I think that you kind of got hit by as you launched both the UK and Latin America -- should we expect a similar type negative impact on profitability internationally, as you get into markets like France and Germany?

David Wells - *Netflix, Inc. - CFO*

Well, we didn't give specific guidance, Rich, in terms of an actual number. But I would say that, if you think about the UK and looking at our financials at the time we launched the UK, that was a substantial market for us. If you look at what our financials would be today, and into 2015, given the comment about our international profit, starting to be profitable, starting in 2015, then you would have to assume that those investments will be of that size.

Doug Anmuth - *JPMorgan - Analyst*

Just moving over to profitability on the US side -- I think in the quarter, you saw about 460 basis points of year-over-year increase in contribution margin, David. Where do you feel like you generated the most upside here?

David Wells - *Netflix, Inc. - CFO*

You mean in terms of the year-on-year growth, Doug? Or are you talking about versus forecast?

Doug Anmuth - *JPMorgan - Analyst*

Yes. Sort of versus the 400 basis points.

David Wells - *Netflix, Inc. - CFO*

Sure. Year-on-year growth really is about growing our members faster than we're growing our content spend. So, I don't think there's any one particular leverage point, other than a managed level of content growth. We continue to get more efficient across other parts of our Business, but the content spend is the largest piece of that, so it's about managed growth.

Rich Greenfield - *BTIG Research - Analyst*

Question for Ted: When you look at House of Cards, I think there have been a lot of focus on the fact that, or you had even said before that season two would have a bigger impact on your overall subscriber growth and net additions than season one, because people had become comfortable with the show. When you look at what happened in Q1, did that actually bear itself out? Is there a way to actually show or tell that season two of House of Cards actually had a greater impact than season one?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Yes, we're getting more sophisticated about how we measure it as well, Rich. I think that what we see is a hungry audience for season two, versus a curious audience in season one. So, where, in season one, Netflix subscribers had no idea what a Netflix original series would be like. So, there was some curiosity, but certainly not a lot of excitement going in.

In season two, there was a lot of pent-up demand. We saw a lot of very early front-weighted viewing for the launch, which told us that America was ready for more, and dug in right away.

As we mentioned in the letter, we've been absolutely thrilled so far with the show from the early launch, relative to how you would measure television on any show on basic cable or premium cable. And I only give you that information, by the way, to help you understand the class of viewing, to think about a show like House of Cards.

Rich Greenfield - *BTIG Research - Analyst*

And do you think that shows have become more -- are shows becoming more expensive, prompting you to need to raise pricing to afford the shows that you want to create, just because the cost of an individual episode is rising throughout the industry?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Partially, Rich. I think what's happening is that we're committing to larger-budget shows, not that the same show is more expensive to make year on year. We're looking at the kind of shows that we're competing with -- we're still only competing with the top end of cable for those shows. And so, think about it like a sports team, where the bidding can get quite high on a couple of key pieces of talent, but the overall salaries stay in check.

Doug Anmuth - *JPMorgan - Analyst*

And, Ted, do you feel like you're seeing a similar dynamic play out as you head toward the second season of Orange, as well here, in terms of the way the viewer base builds?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Yes, we had said before: Orange is the New Black has been our most-watched show. So, we're pretty excited to see what an even bigger mob looks like who is hungry for season two, starting June 6.

Rich Greenfield - *BTIG Research - Analyst*

And, Ted, when you look at HBO, they had a big hit this last quarter with True Detective. I think it was a show that Netflix was bidding on, and actually wanted, and thought would work well for Netflix.

Curious: They still rolled it out on a week-by-week basis, and seemed to build a lot of excitement and social media buzz around their releasing strategy. Do you ever look at kind of what is happening at HBO and say: Maybe there are other ways of doing things in the US, the way you even experimented with doing it overseas?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

We look at it all the time. I think that works well for them. I think this works well with us -- for us.

I think the promise for our members is that we're going to stay focused on what they like; and what they like is to watch more than one at a time. And we don't know the exact magic number of how many at a time, but giving people the option to watch as much as the entire season, I think, works well and fits well with our brand promise.

By the way, it may be that in the future we could roll out shows in different release models the way we did with the Turbo cartoons. And, like, to your point, we are in other countries with other American -- US TV shows that we premier outside of the US, like we will with the Breaking Bad spinoff, Better Call Saul, as we did recently with From Dusk Till Dawn, and we will with Fargo.

Doug Anmuth - *JPMorgan - Analyst*

A question for Ted, and for David: Are you still on track, would you say, to double your investment in originals in 2014, but still keep it below the 10% of total content spending level?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Yes, that's in our -- it had been in our previous, and that's the way it's still trending.

David Wells - *Netflix, Inc. - CFO*

This is David. I would say, Doug, that we migrated away from the 10% number, just because that number's going to grow. It's going to get bigger and bigger and bigger. But yes, it's still accurate to say that we've doubled year on year, but it's still, as a percent of our overall content spend, is less than 10%.

Rich Greenfield - *BTIG Research - Analyst*

I guess this is a question for Reed, although it probably could be addressed to a few of you. When you think about the amount of money you're going to be investing in content in 2015, especially with the firepower you're going to get from the price increase, how do you think about your total addressable market in the US? Is it starting to move towards higher levels than you had thought before, just given the amount of content you're actually going to be producing?

Reed Hastings - *Netflix, Inc. - CEO*

Rich, about three years ago we identified the model that we think, in the fullness of time, we can be 2 to 3 times larger than domestic HBO, linear HBO, which would be 60 to 90 million subscribers in the US. And that model anticipated that, as we got to 40, we'd get better; as we got to 50, we'd get better. So, I would say all of those improvements in the model that we think of are built in to our 60 to 90 million member projection for the domestic market; and so, we'd stand by that.

Every year that we add another 5 or 6 million members makes us feel a little bit more confident of getting into that range, which is great. And then with that, we're able to add more content and continue to make the service better.

Doug Anmuth - *JPMorgan - Analyst*

Just following up on that question, can you -- Reed, can you comment on whether the recent subscriber growth performance is coming more from gross adds or from lower churn? And in particular, can you give us some more detail on what has been happening to churn in the US over the past year?

Reed Hastings - *Netflix, Inc. - CEO*

Yes. Think of most of the growth, Doug, as coming from member satisfaction. When members are really satisfied, they tell their friends about the service, and they retain better. It's really driven from that member sat. When we have great shows coming, and unique exclusives, and things that make people feel passionate about Netflix, then they're, again, more likely to tell their friends, and more likely to stay.

And so, it's a mix of both of those things, but fundamentally it's member satisfaction. Without member satisfaction, you can't get much growth, and, of course, you don't have good retention; but with it, you get -- both aspects are very good. And that's what we've been really focused on.

In the letter we talked about our advertising strategy evolving towards more emotive and brand and content, and away from direct response. We've realized through testing that we don't need to be running around saying: Netflix free trial, nearly as much. We think that's very commercial and reductionist, and that by focusing on the core elements of member satisfaction and the content that you get if you join Netflix, we can get to a much bigger market share, and a better connection with members. And then when they come to our website and see that they get a free trial, they're doubly happy, but that's not the core reason to come to Netflix.

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Reed, too, if I could elaborate on it -- going back to Rich's earlier question about satisfaction, the all-at-once model -- the one thing that sure generates is a lot of satisfaction. If you're stuck in Washington, DC or New York in the middle of a snowstorm, and you want to spend a weekend watching House of Cards, it's something not only that brings people a lot of joy, it's something you can't do anywhere else. That's why we invest in that model as well.

Rich Greenfield - *BTIG Research - Analyst*

Reed, it sort of seems like you're looking at HBO, where they never talk about: Hey, HBO is $15. They just talk about the value that HBO brings to the consumer from a content standpoint. Is that fair to think about?

Reed Hastings - *Netflix, Inc. - CEO*

I wouldn't say it's because of HBO. I think of it as many great services talk about how they're great, and then the pricing is fair, and you have to pay to get the thing. But you want to talk about the great aspect of the service and bring that to the fore; that's generally great marketing.

HBO is an example of that great marketing. But we're not trying to copy them, specifically. We're learning and doing best practices, as they've been doing for a while.

Doug Anmuth - *JPMorgan - Analyst*

Reed, just another question -- a little bit related to the competitive landscape. Amazon has seen some strong growth recently in terms of Prime subscribers, saying that they're basically north of 20 million at this point; also rolling out Fire TV. How is all of that impacting Netflix? And what are your thoughts on the recent Prime price increase, and whether that has any impact to you?

Reed Hastings - *Netflix, Inc. - CEO*

Prime's a great service. I'm a Prime member, and most Netflix employees are Prime members, and it's coming across to most people in our societies as very complementary to Netflix. People look at them as multiple channels.

You saw that Amazon included us on the Fire TV, and, of course, we've been before on the Kindle Fires. And it's a great relationship all around, where we've got unique content. They've got some unique content. They're also doing originals.

There's multiple networks out there. It's very much not a zero sum game, and we're building this ecosystem together that's about internet video. And the more players they are in internet video, the bigger that ecosystem gets. And the big theme is: Internet video is taking share away from linear video. And so, we're all participating in that transformation.

Rich Greenfield - *BTIG Research - Analyst*

When you look at net neutrality, peering, interconnection, Reed, you seem to -- you wrote a letter that basically made it sound like you thought that peering and interconnection was a direct net neutrality violation, or at least violated the principles. FCC Chairman Wheeler said they are more cousins than they actually are the same thing.

You had said, I think, two calls ago, that you would not need to pay distribution, meaning ISPs, for the amount of content you were serving. You reversed that this quarter. Just from an overall standpoint, can you just address what happened this quarter with Comcast, and how you think about the future of the internet?

Reed Hastings - *Netflix, Inc. - CEO*

Sure. The internet is in constant evolution, in terms of the relationships and interconnection that we see. So, we did end up choosing to pay Comcast to improve the video quality that our members experience. We don't think we should have to, but in the short term, we felt like we had no choice. So, we've got that deal in place.

In addition, we're lobbying for this idea that we think is very natural, which is interconnect is part of net neutrality. It's a stronger form of net neutrality. And now we're in opposition to the Comcast-Time Warner merger, because we're really concerned about what happens when the combined entity, if the merger were to go through, would have, with over 60% of US homes passed, and eventually over 50% of US homes subscribing to cable internet; and that's a worrisome factor. So, we think it's more in the public interest to either not have them merge, or, if the government goes ahead with it, to at least put some significant merger agreements -- settlements in there.

Doug Anmuth - *JPMorgan - Analyst*

And, Reed, just as a follow-up, when you say that you had no choice, I'm assuming that's coming from a member satisfaction perspective. Did you see a change in relation to churn, or just overall member satisfaction in the Comcast footprint? And then, can you also talk about -- since that deal was signed and you've obviously seen big pickups in speed since then, whether you've seen a corresponding lift in member satisfaction as well?

Reed Hastings - *Netflix, Inc. - CEO*

Not that I know of. I don't think we've surveyed member satisfaction differentially between Comcast. I imagine it is very much true, but we had years of good experience on Comcast broadband for our members, and then it was only in the prior six months when it started declining rapidly. So, it's a fairly short-term thing. We're glad we've got that now fixed.

I think it will just -- it will work out over time, if we can get to no-fee interconnect, not only for Netflix, but for Cogent, for Level 3, for Akamai. We're going to have a bigger, stronger internet if everyone can agree that that's a better model than, say, retrans, which started off with a very small fee and then escalated into this blackout-type model that's been a real problem for the industry, and for consumers. So, we're trying to avoid that by seeing if we can move everyone to no-fee interconnect.

Rich Greenfield - *BTIG Research - Analyst*

But I assume if we had, Reed -- if we had Brian Roberts sitting on this panel, he would basically look at what you've just said and say: I spent billions of dollars to dig trenches to get the internet, meaning to get Netflix from your offices all the way out to consumers all across the country. If you're going to take up so much of that capacity and force me to actually spend even more money to reach that end consumer, that's not all going to be on me, you're going to have to pay for some of that.

What's wrong with that, I guess, in terms of you sharing the burden? The reality is: There's always been paying on the internet, whether it's been Level 3 or Cogent. It's not like the concept of peering and interconnection being paid peering is a new concept.

Reed Hastings - *Netflix, Inc. - CEO*

No, actually it is. So, in the original days of the internet, it was the opposite, which is: The ISP paid Level 3 for interconnect. And it's only the very large ISPs that now are able, first, to demand they're not paying, and now to demand payment from the transit. So, there's been a real shift in the last five years.

But Brian Roberts is incredibly thoughtful. I'd say: If there's anyone that you wanted to trust with controlling half of the US internet, you might pick Brian Roberts. He's very thoughtful, very long term about it, and very reasonable.

But I don't know that we want anybody to control half of the US internet. That's the real basis of our objection to the merger.

Doug Anmuth - *JPMorgan - Analyst*

Reed, how do you think about the likelihood that you would potentially do similar interconnect deals with other providers -- with telcos, for example?

Reed Hastings - *Netflix, Inc. - CEO*

Well, we've got peering agreements and interconnect agreements with probably 100 ISPs around the world, including many very large ones. That's an ongoing state. It was only in the case of Comcast, when it got to such a bad state, and then recovered very quickly, thankfully, that it was so visible.

Rich Greenfield - *BTIG Research - Analyst*

And then just a question for David, I guess tied to all of this. Could you give us any sense on how these deals are structured, meaning: Is there any way to think about what the cost of interconnection is going to be to Netflix, from a provider like Comcast? Does it account for 4K, or when you launch 4K, do you have to pay Comcast substantially more, et cetera?

David Wells - *Netflix, Inc. - CFO*

Rich, we don't talk about the exact specifics of the deal. But as you might imagine, we have been thoughtful about what might be important down the road in the future, including those items that would be important for us to provide our consumers. Comcast and the interconnect fees that we might have to pay are a portion of the expenses that we've borne, including increased content, as we've added more and more content. I would say it's part of the pattern; content continues to be our most -- our largest piece of expense on our P&L.

Doug Anmuth - *JPMorgan - Analyst*

Reed, just to follow up there: When you think about the amount of bandwidth capacity that Netflix is utilizing, as well as other just large internet companies, is there a longer-term capacity problem in the US, just in terms of bandwidth, especially as you push more toward 4K TVs?

Reed Hastings - *Netflix, Inc. - CEO*

Doug, you can think of it as Netflix is using this bandwidth, but I think it's more correct to think of it as consumers are paying for a 20-megabit or a 50-megabit package from an ISP. And then they deserve to be able to use that speeds that they've paid for. (technical difficulty)

Rich Greenfield - *BTIG Research - Analyst*

-- and the importance of IPTV boxes to your Business. We went to the Amazon Fire TV launch. When we were using the box, we noticed that when you said something like --

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David Wells - *Netflix, Inc. - CFO*

Sorry. I'm being told that we're going to interrupt for a second, and just stand by. We may have had a blip here. We're going to restart. I'll have to ask you to restart your question.

Rich Greenfield - *BTIG Research - Analyst*

Okay. Tell me when.

David Wells - *Netflix, Inc. - CFO*

Sure thing. At least this time we had a protocol for a restart here.

Reed Hastings - *Netflix, Inc. - CEO*

Did we lose the last question?

David Wells - *Netflix, Inc. - CFO*

This is David Wells. Are we back live? Okay. Great.

This is David Wells. I apologize for the interruption. I'm going to ask Rich Greenfield to repeat just the question he just asked. Rich, please repeat.

Rich Greenfield - *BTIG Research - Analyst*

Hi. Reed, we attended the Amazon Fire TV launch recently. And when we were using the device, we noticed that if you said the words, Downton Abbey, it immediately brought up all of the content that was available as part of your Amazon Prime subscription. But yet when you said something like, House of Cards, it immediately did bring up the content; however, it was only for Amazon's paid service. You had to actually buy each individual episode.

When we asked why it didn't actually direct you to the Netflix app, which is a featured app, it said because they don't have access to your API, unless you want them to have access to your API. That brings to the question of: How do you think about how you work with an IPTV box, like the Fire TV, which is also a competitor in Amazon Prime, for video?

Reed Hastings - *Netflix, Inc. - CEO*

Well, Amazon's been very straightforward about treating that platform as an open platform. And we definitely want to be in voice search, and we will be in voice search; we're just still working on the mechanics of it. There's no fundamental issue. It's just some timing and scheduling things that came together. I wish we could have made the initial launch date, but it's definitely something that will come out this year.

Rich Greenfield - *BTIG Research - Analyst*

You don't mind the overarching search being driven by Amazon search versus your recommendation engine?

Reed Hastings - *Netflix, Inc. - CEO*

We have that capability also on different MVPD boxes; also on the Roku, where there's an overall search for titles. So, we recognize that. When you're in the Netflix app, you get a more custom tailored search experience, with various suggestions, but it's up to us to continue to improve that. Amazon's been extremely straightforward and open about allowing us to use that voice search, and that's something we're working on.

Doug Anmuth - *JPMorgan - Analyst*

Reed, in your letter, you mentioned MVPD integrations coming in the US this quarter. Is it fair to assume that you'll continue to maintain that billing and customer relationship going forward? Will they look like the initial MVPD set-top box deals that you've done in Europe?

Reed Hastings - *Netflix, Inc. - CEO*

Definitely, that's a way to start. It can also look like the Apple TV, where that's billed through iTunes. Whether it's iTunes, PayPal or Virgin doing the billing, it doesn't make that much difference. So, you'll always have, as a consumer, multiple options in how that's integrated. As long as it's a separate line item on the bill -- whatever the price of Netflix is in that territory.

Rich Greenfield - *BTIG Research - Analyst*

Reed, given the peering interconnection deal you signed with Comcast, is it fair to believe that at some point this year you'll actually be on the X1 box, which I know is something that you've talked about wanting to be on?

Reed Hastings - *Netflix, Inc. - CEO*

We're definitely staying in a state of: We want to be on it. But I don't have anything more to announce today.

Doug Anmuth - *JPMorgan - Analyst*

Ted, just, in terms of content, we get a lot of questions about House of Cards season three, and what's going on in Maryland, in terms of production, and Reed is smiling now. Can you just give us a little more color in terms of the status there? Is there any concern here for Netflix customers or investors going forward, around that third season?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

No. Keep in mind: The relationship is fairly complicated there, where you have the production company who receives the benefit of a tax incentive from the state of Maryland to keep the show in Maryland. And there have been ongoing negotiations between MRC, who produces the show for us, and the state of Maryland. But I would anticipate that these are overcome-able issues, and it's a very competitive world out there in terms of attracting production.

The tax incentives in place for House of Cards in Maryland have resulted in hundreds and hundreds of jobs, and not just for actors, but for carpenters and waitresses and hotel workers. The amount of hotel nights and meals that the production of a television series brings to a state is staggering. So, I think this has been one of those really interesting kind of political volleyballs in Maryland. But Maryland's been really great to the show, and we love being there, and we're hoping that MRC and the state work that out. But the investors and fans are not at risk in any way.

Rich Greenfield - *BTIG Research - Analyst*

Ted, as a follow-up on content, have you started to see leverage from your international distribution footprint, in terms of getting the rights to a series? Meaning: Now that you're in X number of countries outside the US, is it becoming easier? Is that an advantage to actually buying series, or is that still on the come until you launch more major countries in Europe and Asia?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

It's helpful that -- that's where I think we'll see a lot more meaningful measurement of it, as we expand more aggressively. But I think even seeing things like doing licensing North America together, you see it in where we're launching, where we're premiering shows that premier on US networks, on Netflix around the world; being a single buyer for multiple territories puts us in a unique class of buying. And we hope that we realize some economic advantage of that.

But also, just in being able to coordinate a massive marketing relationship with the studios and networks that produce those shows, that we can then take and be a one-stop for them, in a world that's pretty fragmented today. So, I think we could bring a lot of efficiencies as a global buyer. Just today, the studios and networks aren't set up to be global sellers yet.

Doug Anmuth - *JPMorgan - Analyst*

Ted, just following up on that, do you want to move more toward owning original content directly, more end-to-end and the effect giving you sort of greater control over international rights, distribution going forward? How do you think about that?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Doug, I think we see it as what we want to do is we want to be able to make those decisions for how the content is exploited; and the more ownership you have, the more likely you can do that. But you can also do that in negotiations in very long-term license deals, as well.

So, I don't have any religion around ownership versus licensing, as long as we get that suite of rights that we're looking for. And you'll see us, going forward, doing a mix of both, because once you decide you're only going to do programming that you own, I think that you forego a lot of great programming. I think we've actually seen that in the kind of weakening of the programming on networks today, that lean more to like almost 85% ownership, that the quality of the programming suffers for it. We want to put the quality of the programming first, and then the set of deals second. But all along what we want to do is be able to have much more control over the way the content is exploited on and off of Netflix.

Rich Greenfield - *BTIG Research - Analyst*

And, Ted, are you -- are deals that you're not getting purely based on price? Meaning: You just don't have enough dollars that you can allocate to original programming, and so, you couldn't bid to win something like True Detective? Or are there still shows that want to be on one of the existing linear traditional television outlets?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

No, I'd say that a lot of the programming that we're seeing premiere are shows that have passed through these doors, and it's not that we couldn't afford them, it's just that relative to what we believe the audience is, the deal didn't make sense. You either want to make a deal at the price that you want, or one that you'd be happy to see your competitor pay. A lot of that is at play.

I don't think there's any -- we would rather be on one versus the other. I think that Netflix is a number-one or a number-two spot destination for these shows, almost across the board these days. We're very proud of that, and happy with that.

Doug Anmuth - *JPMorgan - Analyst*

And, Ted, where do you stand with rights to recent originals like House of Cards and Orange in international markets? Would you launch in certain markets, for example, France and Germany, if you did not have all of your original content there?

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

Yes, sure, we would, because we're going to have a lot of new original shows that will launch between now and then. And we'll also have shows that we're premiering in France and Germany, and other markets around Europe, that we won't necessarily have in the United States.

It's like we talked about earlier with Dusk Till Down, the Breaking Bad spinoff, Better Call Saul, as examples. There's a lot of ways that we're backing the original offering, maybe it's slightly different outside of the US in multiple territories. And some of those original shows, as we launch in other territories around Europe and around the world, we will go back and renegotiate, and pull some of those rights back.

Rich Greenfield - *BTIG Research - Analyst*

Maybe that's a good segue to talk about international. Reed, when you look at international markets, a lot has been made of France and Germany being the next two markets that Netflix targets. I guess, as you think about those markets, how do you think about the competitive landscape in continental Europe, as well as the appetite for US content, relative to where you've launched previously, which are generally more English-speaking markets?

Reed Hastings - *Netflix, Inc. - CEO*

We've seen tremendous success in the Netherlands, where we launched six months ago, and that, I think, encourages us about being able to figure out the right programming formula in each nation. When we've had success in Argentina, we've had success in Mexico, in the UK, in the Nordics, and now Netherlands; we're going to get into a broad set of markets. We're going to learn as we go. If we're very fortunate, we'll have programmed it completely correctly from day one. More likely, we'll figure out some stuff's working, some stuff's not; we'll adjust the formula.

But what we've become really convinced about is: Around the world, people want the convenience of internet on demand video, and that that really is a very big and broad need. So, we're stepping up on the international expansion, and we're just going to be pushing ahead, market by market.

Ted Sarandos - *Netflix, Inc. - Chief Content Officer*

And keep in mind: Our original shows like House of Cards and Orange is the New Black have become enormous successes in all of those territories. In France, as an example, the most popular television show in France is The Mentalist from CBS. I don't think that there's some unique hindrance because it's not a primarily English-speaking territory for Netflix.

David Wells - *Netflix, Inc. - CFO*

Ted, this is David. I was going to make the same point in terms of Brazil being a very non-English-speaking market, and lots of demand for western- or Hollywood-produced content.

Doug and Rich, I think we've got time for one question from each of you.

Doug Anmuth - *JPMorgan - Analyst*

All right. One more each. Pressure's on.

In your letter, Reed, you talk about -- when you're talking about the 2Q guidance or the outlook there, you basically talk about -- you use the words, even in a year with full-year growth, in terms of subscribers. So, I guess, what gives you that confidence this year in 2014 that you can deliver more net adds than you did in 2013?

Reed Hastings - *Netflix, Inc. - CEO*

Well, we always hope to grow net adds, both on a year-over-year basis, and quarter over quarter. We're making good progress on that.

But I don't think that we have specific guidance -- we don't have specific guidance for the year. So, what we're saying there is really a mathematical point, which is: Even in a year where you're up year over year, you can have Q2 be down year over year, because of the increased seasonality.

So, you wouldn't want to interpret that or misinterpret it as a backhanded way of sliding in full-year guidance. We're just sticking with our quarterly guidance model at this point, and things are looking good.

Rich Greenfield - *BTIG Research - Analyst*

Reed, when you think about international expansion, one of the things that I think a lot of investors have emailed us about is pay TV penetration. And obviously, you're a broadband, or your service rides on broadband, but a lot of people look at the relative pay TV penetrations in several of these overseas markets. Do you look at that as a key driver of where you decide to launch? Or is it all about broadband penetration? Meaning: What are the key things you're looking at to figure out where to launch next, and what the total addressable market is in each of these countries?

Reed Hastings - *Netflix, Inc. - CEO*

Well, I think we're going to turn out to see that the total addressable market over time are human beings that enjoy TV shows and movies, because everybody's going to be on the internet. In terms of pay TV penetration, it's relatively low in the UK -- about 60%, and we've been very successful there. So, when we look at that, we just see there's an unmet need. And whether something is a relatively small broadband -- or sorry, small pay TV penetration, or already large like Canada at 90%, we've been successful in both of those kinds of markets.

And again, it comes back to the fundamentals of people wanting to have the convenience and simplicity that the internet enables, whether that's on a smartphone, on a tablet or a smart TV. That's what's making us optimistic about the long term in international. Each quarter, we'll have some real work to do, to figure things out. But I think we're going to find that it's a very big opportunity.

Go ahead.

Rich Greenfield - *BTIG Research - Analyst*

Are you seeing wireless become a bigger part of your story, in terms of actual time spent watching, especially overseas?

Reed Hastings - *Netflix, Inc. - CEO*

There's a funny dichotomy. So, there's a good amount of watching on a mobile phone, but usually when it's on Wi-Fi because of the data caps. So, wireless plans, cellular plans generally have data caps between 2 and 5 gigabytes, which you can use up pretty quickly. And consumers are very aware of whether they're on Wi-Fi or not, and so they're using the mobile phones and tablets, but mostly on Wi-Fi rather than on cellular.

Now, if, with 4G, we see more competition and lowering prices, and eventually uncapped plans, as they try to compete with wired, then we could see more of that. But right now, that's not what we're seeing in wireless.

So -- go ahead.

Rich Greenfield - *BTIG Research - Analyst*

I was going to say: So, if the FCC kind of seems focused on encouraging intermodal competition, if Sprint and T-Mo were to actually merge, that could actually create more competition for Comcast, and be good for Netflix?

Reed Hastings - *Netflix, Inc. - CEO*

It's a long way till 4G. They first have to be competitive with Verizon and AT&T Wireless, and that's quite a challenge that they're focused on. So, I'm afraid that that, as a realistic alternative, is very speculative at this point that they would be able to compete for residential broadband with cable. So, at this point, cable's the dominant technology.

So, with that, let me thank you guys for being on and interviewing us. David, did you want to close?

David Wells - *Netflix, Inc. - CFO*

No, I was just giving you the heads up that we're out of time. So, please, conclude comments, and go ahead.

Reed Hastings - *Netflix, Inc. - CEO*

Great. Okay. Thank you, everyone. With that, we'll sign off. Thank you.
