Q3 2019 Earnings Call

Company Participants

- Gregory K. Peters, Chief Product Officer
- Spencer Adam Neumann, Chief Financial Officer
- Spencer Wang, Vice President of Investor Relations
- Theodore A. Sarandos, Chief Content Officer
- Wilmot Reed Hastings, Co-Founder, Chairman, President and Chief Executive Officer

Other Participants

- Michael C. Morris, Analyst

Presentation

Spencer Wang {BIO 3251222 <GO>}

Good afternoon and welcome to the Netflix Q3 2019 Earnings Interview. I'm Spencer Wang, VP of IR and Corporate Development. Joining me today are CEO, Reed Hastings; CFO, Spence Neumann; Chief Content Officer, Ted Sarandos; and Chief Product Officer, Greg Peters. Our interviewer this quarter is Mike Morris from Guggenheim. As a reminder, we'll be making forward-looking statements and actual results may vary.

With that, let me turn it over to Mike for his first question.

Michael C. Morris {BIO 2323139 <GO>}

Thank you, Spencer. Good afternoon. Let's start by talking about both member trends and the outlook that you just provided for members in the fourth quarter. Starting with the third quarter, can you speak a bit about some of the key drivers that -- your results came in relatively in line with your guidance. Talk about the gross add dynamic and the churn dynamic there relative to what you were expecting coming into the quarter, please?

Wilmot Reed Hastings

Relatively in line, it was the most accurate member forecast we've had in years. Spencer, over to you.

Spencer Adam Neumann {BIO 3006410 <GO>}

Spencer or Spence? I'll take it -- we've got a lot of Spencers on the call. I'd first say, Michael, it was a really strong quarter. I mean, not just around subscribers but on overall business performance, there was record revenues for Q3, record operating profit at nearly $1 billion of operating profit and record paid net adds for the quarter.

We delivered on the subscriber front slightly ahead of where we expected, outside of the US. In the US, we were a little bit short. To your question what -- we're talking very small numbers here, but we did see some elevated churn in the quarter that -- we had seen some elevated churn following our price increases in the US and that ticked up and sustained through the quarter longer than it had in the past, but these are really small changes. We're talking about like 0.10 percentage point in churn. And that's why at the same time these price increases are hugely revenue-positive for us as you saw in the quarter, and so we take a bulk of that revenue and reinvest it back into service, into great content, into great product experience for our members to continue to deliver on the value proposition and continue to grow our business.

Michael C. Morris {BIO 2323139 <GO>}

Okay. I want to come back to the topic of churn. But before we do, I just want to ask about the fourth quarter outlook. On the last call we spoke about potentially seeing a record year of net subscriber, net member additions in 2019; the guide does not imply that at this point. So can you talk a bit about perhaps, what changed, and I think the big question in investors' minds is, will 2018 represent a peak year for member adds or can you get back to growing on top of that level again?

Spencer Adam Neumann {BIO 3006410 <GO>}

Sure. I'll take that one again, too. So in terms of our guide for the year, yes, it is down a bit from our previous forecast and really what we're just trying to do there is to be prudent about -- there is a number of moving parts in Q4 and variables that are just difficult to forecast and whether it's, first, just the ability to be precise about a forecast around our content slate that has so much new IP in Q4 and big film -- a big film IP that, we've never had a quarter with so many big films launching in a quarter. Combine that with some of that elevated churn that we saw in Q3 and the potential for that to continue into Q4.

And then lastly, there is obviously a few new competitors launching in the near-term and we try to factor that in as well. Inevitably, there's probably going to be some curiosity in some trial of those competitive service offerings. So when we put all that together -- again, we adjusted our forecast slightly, it's still nearly 27 million paid net adds for the year, a tremendously strong year and furthermore, it is -- our long-term outlook is unchanged in terms of the long-term opportunity for the business. We're just trying to be prudent about our Q4 forecast.

Wilmot Reed Hastings

And Mike, prior year in the US, we did 5 million net adds. And this year, if we're on forecast, it'll be about 2.6 million. So the gap is almost entirely in the US, and that's really on the back of the price increase. There's a little more sensitivity, we're starting to see a little touch of that, and what we have to do is just really focus on the service quality, make us must-have. I mean, we're incredibly low priced compared to cable. We're winning more and more viewings. We think we have a lot of room there. But this year that's what's hit us and we're just stay focused on just providing amazing value to our members in the US. And I think that gives us a real shot at that continuing to grow long-term net adds on an annual basis. But we're going be a little cautious on that guidance and feel our way through here.

Michael C. Morris {BIO 2323139 <GO>}

And on that elevated churn, just to kind of wrap on this, what type of subscribers, are you seeing churn more often? Does it tend to be really that hit-driven nature around particular programming, does it happen to be sort of the last subscriber in is less sticky? What are you seeing there?

Wilmot Reed Hastings

Mike, 0.1%, it's one in a thousand people, so you really can't tell on the margin. Think of it much more big picture, which is, it's always a question of how much value do we have, how do the consumers feel it? And moving up ASP in the US from about $12 to about $13, we see a little bit of it and then what we had to do is just give it a pause and really focus on the value. If you think about it, we haven't had many big movies in the past and movies are very valuable, people are used to paying for a lot of that and the slate that Ted and his team have this quarter and for next year is way better than any movie slate we've ever had. So there is some great room for optimism there. So we just have to focus on the members and I think it will shake out very well.

Michael C. Morris {BIO 2323139 <GO>}

Okay. Thank you. So let's talk about competition, Spence brought the topic up. So I'm not introducing it. I know it's been a hot topic. But Reed, you spoke in the UK a couple of weeks ago, you made a comment, saying it would be a whole new world starting in November. I think, a lot of people -- lot of investors just read the quote, they didn't necessarily see the interview for context. And so, I love it if you could provide some context, given that that is a bit different from your comments from a couple of quarters ago where you felt that perhaps, these new services wouldn't necessarily be material to the outlook?

Wilmot Reed Hastings

From when we began in streaming, Hulu and YouTube and Amazon Prime back in 2007-2008, we're all in the market. All four of us have been competing heavily including with linear TV for the last 12 years. So, fundamentally, there is not a big change here. It is interesting that we see both Apple and Disney launching basically in the same week after 12 years of not being in the market, and I was being a little playful with a whole new world in the sense of the drama of it's coming. But fundamentally, it's more of the same and Disney is going to be a great competitor. Apple is just beginning, but they'll probably have some great shows too. But again, all of us are competing with linear TV and we're all relatively small to linear TV. So, just like in the letter, we quote about the multiple cable networks over the last 30 years, not really competing with each other fundamentally, but competing with broadcast and I think it's the same kind of dynamic here.

Theodore A. Sarandos {BIO 4812832 <GO>}

I think, I got the subtlety of the brave -- the whole world, a Latin reference, everyone else got you pretty literal.

Wilmot Reed Hastings

And Ted, why don't you talk a little about the movie slate and how it's different. If there is a whole new world, it's really about our movie slate more than anything else.

Theodore A. Sarandos {BIO 4812832 <GO>}

100%. I think we've got just in the fourth quarter alone, you're talking about films that are -- that range from massive scale action film from Michael Bay with 6 Underground to Oscar hopefuls like The Irishman, Marriage Story and The Two Popes, Eddie Murphy's return in Dolemite. So these are big theatrically ambitious type films that you'll be able to watch on Netflix included in your subscription. It really is a fundamental change in the economics of how people enjoy films. So we're really excited about it and it's our first time we've seen this scale and this volume of films in one quarter. So, we're really excited about it.

Michael C. Morris {BIO 2323139 <GO>}

Before we dig into some content questions bit more, I do want to talk about pricing a little bit and the pricing power in the US market. So perhaps for Greg or for Spence, two things: Number one, do you think that the lower price point for some of these new services will negatively impact your ability to raise your price in the future? And maybe more broadly, can you talk about the equilibrium price for the service? We would love for you to give us a price point; I know that's unlikely, but as you just think about -- you could be a great value with a number of different price points, but how do you think about where that sort of shakes out?

Gregory K. Peters {BIO 17539678 <GO>}

Yeah. I think the pricing of our competitors, we don't feel is a real significant factor in determining what we can charge for our service. Again, the services and the content are highly differentiated, so one is not something you're going to choose to do just for us. But I would say, our job and what we think our pricing for a long-term perspective is continue to take the revenue that we have that our subscribers give us every month, judiciously and smartly invest it into our increasing variety and diversity of content, where we really want to be best-in-class across every single genre. And if we do that and we are successful in making those investments smartly, we'll be able to continue to deliver more value to our members. And that really will enable us to from time to time, ask for more revenue, so that we can continue that virtuous cycle going.

Michael C. Morris {BIO 2323139 <GO>}

And so, I don't know if you could speak any more about it, but is there a place where whether it's relative to a pay-TV subscription in a certain market or relative to other streaming services that you think, set some sort of bound around where pricing could ultimately go to?

Gregory K. Peters {BIO 17539678 <GO>}

Yeah, I think you can look at a couple of external ones, in terms of pay-TV packages that might be relevant. We don't really look at it that way. We're looking at it more sort of incrementally and let our subscribers sort of tell us as we add more value along where that right price should be. So we're really more focused on listening to subscribers and sort of walking that path with them.

Michael C. Morris {BIO 2323139 <GO>}

Okay. And one other question on pricing for you, Greg. A couple of different dynamics especially outside the US where you have different price points, you tested a mobile-only plan, a lower price plan in India. Could you talk a little bit about, perhaps, the variety of tests and pricing plans that you have in the marketplace right now and any differentiation you can give us between more mature markets with some stable pricing, tests, anything like that, so we can get a view of going forward?

Gregory K. Peters {BIO 17539678 <GO>}

Sure. Just to talk a little bit about where we are in India, I mean, again, we think about revenue is the guiding principle for as we do these different tests and trying to figure out, what is the right set of plans that have the right benefits, the right features that are delivered at the right price for the subscribers in any given market. And I think what we're exploring is as we are operating in markets that have very, very different conditions, very different levels of affluence and other forms of entertainment competition, et cetera, what is the right structure for us.

And so, we've been very, very happy with the mobile plan. It's actually performing better than we tested. We'll look at testing that in other markets too, because we think there are other markets which has similar conditions that make it likely that that's going to be successful for us there as well. But I also think we're going to look at other plan structures, other feature value benefits where we might see different market conditions that will work there, and I won't get into sort of leaning into those. We'll see them as we roll out and we'll respond to them based on what our consumers in those markets, our members to-be in those markets are telling us is working or not.

Michael C. Morris {BIO 2323139 <GO>}

Okay. I want to come back to competition, but this time talk about competition for content. Ted, you teed up a bit of some of the things you're enthusiastic about going forward. Reed, you did make the comment, again, on the UK that someday, The Crown would look like a bargain perhaps, another soundbite there was picked up or perhaps you could provide some context around that. Maybe generally, how do you think about the investment that you're making in programming from very high level? Is it an overall budget, is it a cost per subscriber to certain level, how do you think about that?

Theodore A. Sarandos {BIO 4812832 <GO>}

I would say the -- I didn't think about this moment in entertainment history is that the scope and scale and ambition of television is beginning to rival that of feature film, which is an incredible win for consumers. And so when Reed was talking about The Crown he was talking about relative to the joy and the hours of watching, The Crown will look like a bargain and that these things on big scope and scale and we're pretty uniquely positioned with a $15 billion content budget to be able to deliver on that scope and scale at the same time for film and television. So the incredible -- that slate that I just rattled off to you at the -- it's happening at the same time that we have returning seasons of End of the F***ing World, The Crown, Lost in Space, You, all incredibly popular shows, La Casa de las Flores from Mexico, Baby from Italy, all back for returning seasons, breaking brand new series like the Witcher, Daybreak, all at the same time being able to deliver on what we think is an incredible value proposition for viewers. So you were asking earlier about price. It's really price relative to value. And if you're spending more and more of time watching your TV shows and films on Netflix, you're realizing an incredible value and I think that's really how the consumer experiences it.

Michael C. Morris {BIO 2323139 <GO>}

Ted, as much as you can ballpark it, a show five years ago, producing that same show today sort of 50% more expensive, 30%...?

Theodore A. Sarandos {BIO 4812832 <GO>}

It's a really hard one, because of the range is huge and sometimes the big breakthrough is not the one that turned out to be that came into it that competitively. But on a very competitive shows, there's probably been 30% price escalation from this time last year.

Wilmot Reed Hastings

In one year?

Theodore A. Sarandos {BIO 4812832 <GO>}

In one year.

Wilmot Reed Hastings

It's a lot, but definitely content pricing is rising, but we are fortunate to have the largest membership, one of the biggest revenues and the biggest content budgets. And so (inaudible) we're able to still be very competitive for the big [ph] shows.

Theodore A. Sarandos {BIO 4812832 <GO>}

I'm actually pointing out, it's an elite few shows that are that competitive that would see that kind of escalation. It's just in any environment where you've injected a few new buyers, you're going to catch that dynamic on a highly competitive show.

Spencer Adam Neumann {BIO 3006410 <GO>}

The only thing I'd add and also just to reinforce, we look at a lot of things, we don't chase everything and we also lose on opportunities, right? So, we're exercising discipline every -- all on the way with every single title, we're assessing every title individually and we're -- one, as Ted said, with this size of content budget, we'll take big swings and we can make some mistakes, because we don't have any single title content concentration, but we are, because of that discipline, we're continuing to march towards increasing profit margins, improving our cash flow trajectory over time. So this is with discipline and business discipline while we are going after these big swings.

Spencer Wang {BIO 3251222 <GO>}

And Mike, at the risk of hitting it too hard the diversification point, just sort of mathematically investors can do the math on what $100 million for a project relative to a $15 billion cash content budget or $10 billion P&L budget means, it's incredibly diverse, right? So we don't have any sort of concentration risk, so I'd point that out.

Theodore A. Sarandos {BIO 4812832 <GO>}

Considering the math, Spencer, with the idea that the rumored $100 million at House of Cards investment going into the way that that was seen earth shattering less than seven years ago. Today, it represents about 1% of our content budget.

Wilmot Reed Hastings

Today that will be a bargin.

Michael C. Morris {BIO 2323139 <GO>}

So if I look at this dynamic then continued increase the investment in content at the same time growing your subscribers, where are we in terms of achieving scale on that investment, if we look at that content spend per subscriber? Do you expect the competition to continue to drive that up or are we getting to a point of equilibrium where you're starting to see the benefit of that at global penetration that you have?

Theodore A. Sarandos {BIO 4812832 <GO>}

I wouldn't try to take a stab at predicting whether we're at equilibrium when there is so much fluidity in the market today. But, I think what you're seeing now there is a -- there's an absolute cap, of course, but anyone can pay for any given project and it'll get super-competitive for a lot of them. So I'd say that we're investing forward and trying to win those moments of joy for our members, and that's what's driving us.

Wilmot Reed Hastings

Mike, there is about 2 billion active users of Facebook, 2 billion active users of YouTube. We're obviously a fraction of that and those numbers are continuing to grow. There's 6 billion active mobile phones in the world and that's got to equilibrium. So equilibrium is so far away from where we are today. It's not something that we think a lot about, think about how do we grow.

Theodore A. Sarandos {BIO 4812832 <GO>}

Yeah, definitely, in terms of member growth. I thought you're talking about again content spend.

Michael C. Morris {BIO 2323139 <GO>}

Sure. So, let's talk about creating franchises. I have a question about that. I think, there is a lot of enthusiasm as you know for the Disney Plus product coming out. And I think that it rides a little bit on the success of the streaming marketplace, but also this concept that they have this tremendous content library and IP library that they've built over many years. So Reed and Ted, as you think about that, I know you've made an investment in children's content over the course of the last quarter. Talk a little bit about franchises, the importance of franchises and whether building franchises is something that is -- is it your ambition?

Theodore A. Sarandos {BIO 4812832 <GO>}

I think, established IP has a leg up with consumers, they know what they're getting into, there's a pre built-in excitement, makes the marketing a little easier. But in general, don't forget the power of brand creation and then what is the value of a franchise? It's really the value of brand creation and can you scale up of it. In this past quarter, we made a movie called Tall Girl. Thought the -- hugely unknown cast, who in seven days grew their social media following into the millions on Netflix and that over 40 million people watch it. So that's the ability to create a brand almost out of thin air, which I think is every bit as valuable as drafting off of a bunch of other franchises waiting for them to burn out. That being said, we're very excited about the opportunity to do it ourselves. We see the value of franchises like Stranger Things and Black Mirror, and so we're continuing to work to do that as well. But I think about it as not like franchises are better than non-franchises, great stories are what matter and the way that they reach consumers really makes a difference.

Michael C. Morris {BIO 2323139 <GO>}

You had a couple of original programs, original piece of the content markets, outside the US, global pieces, but focused in markets, Sacred Games in India, La Casa de Papel in Spain. I'm thinking about, in particular, we saw Google search activity, let's say, multiples or at least doubling what their prior levels were. So I'm curious your thought about how that piece of content does drive that enthusiasm, in local market? I think, what that ties to really is, I think the way we try to think about what the growth opportunity is, so I'd love to hear why you think you get that big step-up and maybe in terms of Ted and Greg together, how you work together to try to make that happen ?

Theodore A. Sarandos {BIO 4812832 <GO>}

Sure. You saw in the letter, our investment in local language original series and film is continuing to grow. We'll add more than 100 seasons of new local language original shows and they make a huge impact in the market La casa de las Flores, which will be back for a second season in Mexico has been a tremendous success. What's been great too is a lot of these titles that are hugely impactful in the country where they're produced also tend to travel throughout the region and sometimes around the world.

Not so the La Casa de Papel the success of that show was basically in almost every non-English speaking territory. It was a phenomenal success. We see that coming up with new show called The Wave from Germany, well, these stories can be very pan-regional, but the way that they travel and the way that they make a big splash around the world is to be super-authentically local and really satisfying for the viewers, starting in the home country and then expanding around the world. And we've been -- we're in our fourth year of producing local language originals at scale and we're excited about continue to expand it and they can -- what's the nice part is, I think people will enjoy a global film or a global series every so often, love to see themselves on screen and that we're able to deliver on both of those propositions for our members around the world.

Gregory K. Peters {BIO 17539678 <GO>}

Yes. Just to add there, I think it's super fun and exciting to be able to take one of these really authentic local stories and connect it effectively with a broad regional or global audience. In many cases, we feel like we'd have never actually watched the show in that language or from that country before. And the key to doing that, first of all, is obviously being available in all those countries in a easy-to-access way. But then it's connecting that show, having it be localized in language with subtitles or dubbing whatever is appropriate for that market, and then also explaining to users, the members why they're going to want to watch this amazing Heist series from Spain and why that's going to be a totally compelling watch for them based on the other kind of content that they're enjoying.

Michael C. Morris {BIO 2323139 <GO>}

I think, it's important to understand how broad your production is outside the US. So can you share any statistics on how many countries you're actually producing for your first-party production of content and what that sort of investment looks like in terms of building them out there? And then just you did strike a partnership with Mediaset during the quarter, one specific partnership you can perhaps detail how that can benefit you?

Theodore A. Sarandos {BIO 4812832 <GO>}

Well, we've entered into most of those markets in joint ventured or in co-production arrangements at the beginning and then take over many productions in those countries as we get scale in those countries. And we also continue to have great co-production relationships with folks like Mediasets, even though our own studio is producing local Italian content as well. So it's -- I'd say we've released original local language content in 17 countries to-date, we're going to grow it to 30 and that's just going to keep growing around the world.

Michael C. Morris {BIO 2323139 <GO>}

One of the content question, you did make a high profile commitment to rights for Seinfeld, which is a little bit, I don't want to say counter, but certainly different from the focus of allocating resources incrementally to originals. Can you talk about how big of a commitment is that for you, maybe, at least on a relative basis and why is that the right decision?

Theodore A. Sarandos {BIO 4812832 <GO>}

What we've seen -- in the past, we've had a lot of questions about the value of volumes of catalog programming, meaning just having hours and hours of content that people don't watch. But we have seen there's a few titles in the history of television, Seinfeld being one of them, that continue to be incredibly relevant 30 years after it came out on television and get watched every night, it's kind of a comfort view, comedy that travels around the world and Seinfeld is one of these very elite shows that came available in that time frame. So we have Friends unit till the end of the year and then we'll have Office for another year after that and then Seinfeld to roll out to the world in 2021 on Netflix and we're incredibly enthusiastic about these shows. But they are very, very unique in the vast catalog of television ever created that people are still watching 30 years after it was produced.

Michael C. Morris {BIO 2323139 <GO>}

I want to ask you some questions about windowing and sort of creating community among your viewers. One of the questions that we get is really about dropping an entire season at once versus having it spread out over a week at a time. You've addressed this question before, but I'd like to hear your more -- your current thoughts and I think the question is really beyond just why not do it every week, but why do it, let's say, all -- an entire season once; maybe you could split a season into pieces or the timing of a series, for example, we were asked why Stranger Things couldn't have been before the end of the second quarter instead of just after the start of the third quarter?

Theodore A. Sarandos {BIO 4812832 <GO>}

So I'll give you a quick -- just personal anecdote. I'm a big fan of Succession on HBO and I watch it every Sunday night when it comes on, just like everyone else. And if I like that show a little bit less, I would probably burn out on it, because I get aggravated every week waiting for the next episode. That's how much I like it. So we are trying to fine-tune the proposition to the customer of get storytelling how and when they want to watch it and what we have seen in comparison -- because we have about 35 shows around the world that we release week-over-week, because it's premiering in that territory on Netflix and we don't want to -- and we want to deliver on it as soon as close to the broadcast window as we can. So what we -- and what we've seen is in markets where we release all at once versus one a week that we actually get more viewing and cumulatively more social media buzz, more tweets, more activity on social media around these shows for the all-at-once model. So people are coming to it at different times. They are loving it more. It's in a more concentrated experience for sure.

All that being said, we are doing things like producing like you saw with The Ranch, where we are producing 10-episode seasons with smaller gaps between seasons, so they're coming out six months apart rather than a year apart. You're seeing, we're testing a interesting release pattern with Rhythm and Flow, a music competition show. And basically what we're trying to do is match not just the program, exactly that you want to watch, but how do you want to watch it. And for a lot of people, it may not be all at once, but it's hardly ever one a week.

Michael C. Morris {BIO 2323139 <GO>}

Right. Do you see more opportunities for that, whether it's unscripted or the type of program and it's not live per se, but it does lend itself to a little more pent-up excitement. Do you see more opportunities to put resources behind that or is it opportunistic?

Theodore A. Sarandos {BIO 4812832 <GO>}

It's opportunistic. We're trying a lot of different things. What we're trying to do is make your favorite show, whatever that is, and for some people it's going to be a music competition show and for other people, it will be Green Eggs and Ham. So we really are trying to make your favorite show, whatever it is and be best-in-class on all of those things and there might be something unique about the release rhythms of competition shows and more topical talk shows that lend themselves better to frequency of release.

Michael C. Morris {BIO 2323139 <GO>}

You spoke two quarters ago -- we updated a little bit last quarter, the topic of providing some more data or information both for producers' talent, as well as for individuals. My first question is, can we have an update on where we are on that, what you have provided, and especially from the consumer perspective as well, I think the goal was to help create some more of that buzz, create more conversations, how is that playing out ?

Theodore A. Sarandos {BIO 4812832 <GO>}

One of the things you saw, we've launched in the UK, and we're looking to expand presentation of the Top 10, so that people can come to Netflix and see the Top 10 most popular things of different categories. Once again, I think that one way the people choose content is by popularity, it's not the only way and it's not the only way we want people to do it, but if they want to use that as a tool to help guide their decision making, we want to help them do that. So publishing that Top 10 that refreshes every 24 hours is one way that we're helping them on the consumer side. Our producers, we share viewing data with every week on the length of the launch week and the end of the month.

So we're incredibly transparent with our producers around the world and we're going to be increasingly doing things like we did in our earnings letter and give you viewer stats on a lot of our projects as we go. Greg, you want to add anything about the Top 10?

Gregory K. Peters {BIO 17539678 <GO>}

No, I think it's a -- you covered well. And just to make it clear, I mean that Top 10 that's a list that's available in the product, so to Ted's point, those members who really think that popularity, is an important signal for them on what to watch, we'll have that available to them.

Michael C. Morris {BIO 2323139 <GO>}

Great. Greg, I'd like to ask you a couple of questions on the technology or the product side. First, maybe an update on partnerships. We talked about a bit on the last call, I'd love to explain, in the US, the pay-TV partnership seemed to be a big part of the focus. Can you talk about whether that's become a bigger part of the subscriber acquisition product? Is it steady-state? Help us understand where we are in that process?

Gregory K. Peters {BIO 17539678 <GO>}

Yes. It's important, I think, to ground it in the partner-based acquisition component. When you think about all the devices that we operate on, and you're just being able to find and sign up new license, that's a healthy chunk of our acquisition. But then when you get to the bundles, which I think often people think about, partners equals bundles, that's a relatively small, but it's a nice incremental acquisition channel for us.

And so, we'll seek to grow that. We think there's a bunch of opportunities both in the United States with existing partners and expanding the number of bundles and sort of the bundle availability. We'll also seek to expand that globally, because we think there is a tremendous number of opportunities globally to add those kind of partners and make it easier for our members to sign-up. We did a couple this quarter, whether it's Canal Plus and Sky Italia with sort of new partners for bundles. But we've also done things like take KDDI mobile operator in Japan and be able just to expand our presence across their offering, which makes it, again, an easier place, more attractive for more members to sign-up. So it's still small, a relatively small fraction of our acquisition, but it's a nice good incremental way to access a member base -- member-to-be base that's -- it's less technology for less early adopter and we can just make it super-simple for them to sign-up.

Michael C. Morris {BIO 2323139 <GO>}

Okay. Another topic that we haven't talked about a little while is that a password sharing or stealing or whatever you want to call it. As we get to a more mature growth trajectory in the US, does that come back into being something important for you to address and how do you address it without alienating a certain portion of your user base? How do you strike a balance there?

Gregory K. Peters {BIO 17539678 <GO>}

Yeah, I think, we continue to monitor it. So we're looking at the situation and we'll see, again, those consumer-friendly ways to push on the edges of that, but I think we've got no big plans to announce at this point in time in terms of doing something differently there.

Michael C. Morris {BIO 2323139 <GO>}

Okay. And so Spence, I'd like to ask a couple of questions on the financial side. The first around margins and contribution margin. In the past you've spoken to a 40% domestic contribution margin target, is that something that you still view as achievable? And maybe within that context, when you talk about competition, do we need to spend more, say, on the marketing side than you previously anticipated as you achieve what you want to achieve on the subscriber side?

Spencer Adam Neumann {BIO 3006410 <GO>}

Well, first on margins, I guess, so the good news is we did deliver over 40% contribution margin in the US this quarter. Happens to be the last quarter that we're looking at the business in that way, as we talked about in terms of changing that way will be reporting going forward. We noted in the letter that we'll start reporting our revenues and our subscribers on a regional basis, and then global operating margin. That's really because as we move to a world where we're both licensing and producing more and more original programing on a global basis, segment margin is not really the way we think about the business. Increasingly, we think about managing to a global margin. We are breaking out that regional reporting on the revenue and subscriber level, because that level we are directly driving our business at a regional level, as we talked about this quarter, 90% of our growth is outside the US, and so we think about it more than just US versus international.

Frankly, we -- in terms of continuing to grow our margins, again, we look at it on a global basis. We're driving -- we think scale and efficiencies, and margin growth across the board. Our content investment while it's growing, it's growing slower than our revenue growth. And marketing, we will market as we think appropriate and needed to grow our business. We had a very large increase in our marketing spend last year, so this year, you're seeing -- spending similar levels to last year, and that's because we learned a lot, we learned a lot along the way, we'll continue to test and learn, so we find new and different ways to reach our members every day. And so, we'll continue to turn the knobs there, but we're very conscious about continuing to drive up our operating margins on that global basis, that 300 basis point increase this year to 13%. And we talked about in the letter committing to 16% next year. So we'll continue to do that by driving efficiencies in the business while doing the requisite marketing to reach our members.

Michael C. Morris {BIO 2323139 <GO>}

And we will piggyback off some of those fundamental trends you just mentioned. You talked about free cash flow as well, a little bit of a different dynamic with the investment on the cash side, but you talk about progress toward turning free cash flow positive. Can you give us insight on some of the levers there, how to think about and you referenced the coming year, can you just highlight that for us? And then really the progression of the 2020 levels, what your expectation is?

Spencer Adam Neumann {BIO 3006410 <GO>}

Yeah, sure. Again, we're committed to starting in 2020 improve our negative free cash flow profile. We talked about this year that we're expecting roughly negative $3.5 billion of negative free cash flow. Again, that is investment in future content to be delivered on our service. So we are profitable, we're increasingly profitable that's why we see in 2020 as we continue to grow our profit margins, continue to scale our businesses. What you've seen this year, which is nearly 30% revenue growth and then increasing margins, that ultimately translates into more cash flow that can be converted into content investment and improving that profile.

And we've also been transitioning from licensed second run content into original programing, so that created some of that working capital pressure. But now the bulk of our content investment is original programing. So we've made it a long way up that curve. So the combination of our scale and our business model transition is well long and that's why you're going to start to see that free cash flow improvement next year. And then, beyond that, we're not going to give specific projections. We'll continue to scale gradually towards self-funding, while we continue to kind of go after our strategic priorities.

Spencer Wang {BIO 3251222 <GO>}

Mike, we have time for one or two last questions, please.

Michael C. Morris {BIO 2323139 <GO>}

Sure. Well, I'll take the opportunity to finish with a question for each of you, so maybe get a little bit of a five-answer bonus here. But I'm curious what each of you, if you wouldn't mind sharing, are most looking forward to, as we get through the next quarter, and you come to your next earnings interview. What's the one thing that you're most excited about being able to talk about as we look out that? Maybe I'll start with you Spencer and will for convenience we'll go backward alphabetically by last name, so you guys can figure that out. Spencer, go ahead?

Spencer Wang {BIO 3251222 <GO>}

Great. I guess, for me, maybe fewer questions from investors on competition. But I think that's pretty unlikely. So I'll say what I'm, I guess, really excited about the coming quarter is actually 6 Underground, new original film from Ted's team. I'm a big action film junkie, so super-excited about that.

Spencer Adam Neumann {BIO 3006410 <GO>}

I guess I come next. So, I'm super-excited about The Irishman actually. Can't wait to see that film. And also, frankly, it will be nice to have some of these competitive launches in the rear-view mirror, so that we can continue to look forward and all the things that we're excited about in terms of this huge global opportunity.

Michael C. Morris {BIO 2323139 <GO>}

Great. I'll go to Ted next.

Theodore A. Sarandos {BIO 4812832 <GO>}

Look, what I'm most excited about, we got to be able to -- we have to do exactly what we're doing right now, which is we have to continue to make your favorite show and we need to continue to deliver it to you seamlessly and none of that changes in the upcoming. And I think when I look at the quarter ahead, these guys already mentioned Irishman and -- sorry, 6 Underground. But, I also think there are some incredible things in between there with things like Marriage Story, like The Two Popes from Fernando Meirelles, and Laundromat from Steven Soderbergh. These are the most iconic directors of our time making their next film in Netflix. We have a building full of animators, who have made the best animation over the last decade, making their next projects at Netflix. And I'm really excited to be able to come in and update you on those two over the next quarters.

Gregory K. Peters {BIO 17539678 <GO>}

And I'm pretty consistent with that, I think the opportunity to be able to expose our members to the kind of films that we are producing right now that are being released on Netflix in such a compelling way is going to be super-exciting and it's super-fun to sort of look back on that and see how that goes.

Wilmot Reed Hastings

I look forward to blowing away the numbers. Yeah, accuracy is good when we have it, only accuracy, without accuracy. But it's super-fun to blow away the numbers. So fingers crossed, we'll see every quarter, it's a -- forecast is a 50-50 guess, as you see for this year and we'll see what comes.
