Q3 2018 Earnings Call

Company Participants

- David B. Wells, Chief Financial Officer
- Gregory K. Peters, Chief Product Officer
- Spencer Wang, Vice President, Finance/Investor Relations & Corporate Development
- Theodore A. Sarandos, Chief Content Officer
- Wilmot Reed Hastings, Founder, Chairman & Chief Executive Officer

Other Participants

- Eric J. Sheridan, Analyst

MANAGEMENT DISCUSSION SECTION

Spencer Wang {BIO 3251222 <GO>}

Good afternoon and welcome to the Netflix Q3 2018 Earnings Interview. I'm Spencer Wang, VP of IR and Corporate Development. Joining me today are CEO, Reed Hastings; CFO, David Wells; Chief Content Officer, Ted Sarandos; and Chief Product Officer, Greg Peters. Our interviewer this quarter is Eric Sheridan from UBS. As a reminder, we will be making forward-looking statements and actual results may vary.

With that, over to you now, Eric, for the first question.

Q&A

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Thank you, Spencer. Maybe I'll kick off with what clearly is the headline from the earnings results, much better subscriber performance in Q3 and a fairly robust guide within Q4 in terms of looking out on the subscribers. I'll throw it to you guys to sort of lay out the framework you saw develop in Q3, what do you think might develop in Q4 that was different than what happened earlier in the year.

A - Wilmot Reed Hastings

You know, Eric, I think we're getting a little better on the forecasting, in particular the evolution to paid net adds. So, if you look at that paid net add growth that we showed, you can see how remarkably steady. So, I'm afraid the Q2, Q3 story is probably mostly an issue of forecasting as opposed to anything changing in the business, and you can see the noise that the free trials added into the paid, which gives you the total, creates. So, I think by focusing going forward on paid, we'll be able to be a little more accurate focused on the fundamentals.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

So, when you think about some of the distribution deals you've done over the last couple of years, that's creating some noise that I think you're now trying to clear up with these new disclosures. But can you also talk a little bit about what those distribution deals may be in terms of opening up pockets of the market that hadn't been available to you before, not only just this year, but as you think out longer term about the business?

A - Wilmot Reed Hastings

So, over to you, Greg.

A - Gregory K. Peters {BIO 17539678 <GO>}

And can you clarify, Eric, on distribution deals, you mean the device partners, et cetera?

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Correct. Different ways of going to market via partner as opposed to direct.

A - Gregory K. Peters {BIO 17539678 <GO>}

Yes. I think what we're doing is we're slowly learning more and more about how we can leverage partners. We've seen it sort of an evolution from just doing device integrations into things like billing integration, so we can make it that much easier for our members to sign up for the service. This latest round we're seeing now is bundling where – whether we're bundling with an Internet service provider or a mobile operator or a pay TV operator, we can make it even easier for people to just find Netflix and to try the service out.

And what we're seeing here is that this allows us to access a set of subscribers, a consumer demographic, which might be less technology early adopter than the folks that are signing us up – with us directly. And so, we're able to sort of accelerate our growth in a new segment via these deals. So, we're learning more and more about that. We're trying to figure out which markets they work and how to optimize that bundle strategy.

A - David B. Wells {BIO 17034721 <GO>}

Eric, I would say these aren't new disclosures in the sense that that's pretty strong term. I would say this is an evolution of a partner strategy, and as Greg talked about, we've been doing many of these for a while. There's nothing sort of strategically different than what we've been doing for the last five years or so.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

So, maybe following up on something that Greg said there, just where you're discovering growth and awareness of the product that didn't exist before. I'd like to separate that into domestic versus international. I think one of the questions we get from investors all the time are where is the growth coming from in North America given the brand's awareness, given how long the brand's been around in the marketplace. Anything you could tell us about where those pockets of growth are and where you're discovering new awareness for the company?

A - Gregory K. Peters {BIO 17539678 <GO>}

I'd say even in America, where the awareness is super high and the brand is well understood, there's still pockets of consumers who – it's harder for them to get the activation energy (00:03:40) to go directly to the website and sign up. But if we can actually put a Netflix application, a call to action and maybe even bundle the service subscription as part of their pay TV offering or the mobile offering, they can just click on something and then get right into the service. And so, even for a place where we're well-known, if we make it easier, more effective for folks to sign up, we see actual acceleration of adds there.

Then, obviously, in markets where we're less well-understood in terms of what the offering is, that simplifying, that making it less friction full provides (00:04:15) other types of members maybe that are even more technology adopters simple ways to just try the experience out and we get the growth there as well. So, I wouldn't say it's – we're seeing sort of the same dynamic, which is you remove friction and it works both in high penetration, high awareness markets as well as the lower penetration, lower awareness markets.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

One of the other thing, sticking with the domestic market for a minute, pricing power in the business model, you raised prices as we came out of last year and into this year. It's now been a couple of quarters as some of those pricing actions have worked through the marketplace. What have you learned about the value that consumers put on Netflix and how much pricing power that might be in the business model, especially when you look domestically?

A - Gregory K. Peters {BIO 17539678 <GO>}

I think we're just – what we're seeing is just reinforcing this sort of core theory that we have, which is our job is to focus on, invest in providing our members incredible experiences, more great content, great product experiences. And when we do that and we do it well, we earn the right to increase price a bit and then we take that new revenue, invest it back into the model and that sort of continuous positive cycle we get to keep going. And we foresee that that will keep going for many years in the future.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Maybe pivoting back to international, I'd love to talk about both India and non-India. Within India, we saw a big push earlier this year into local language content. I'd love to talk a little bit about what local language content does in India to stimulate subscriber growth and then how you think about penetrating the India market from who you need to partner with and how you have to get pricing right over the medium to long term. So, I'll throw that open maybe to – so, it probably touches a little bit of (00:05:55) everyone within the group.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

I could – this is Ted. I'll tell you (00:05:58) about – we had incredible success with Sacred Games, followed it up right away with Ghoul and prior to that with a movie called Love Per Square Foot. What we really was able to do was take this product that maybe was less known in India when we launched and make it feel more local, more relevant. And what we saw was – all of that was following nice steady increase in viewer engagement prior to us launching those big original shows. So, what they had was a product that people understood more, talk to their friends more about, that was written about more in the press and certainly talked about more by influencers and then delivered with content that isn't otherwise available in the market, a series being produced at the quality – the production quality of Sacred Games by way of example.

A - Gregory K. Peters {BIO 17539678 <GO>}

And then, to the question on pricing, what I would say is we're just getting started in India, and we feel like with the existing model that we have, the prices that we're at, we've got a long runway still ahead of us. And we've seen that in sort of the increasing traction that we're getting in that segment as we have the great content that Ted was mentioning, we increased our partnerships, we're improving the product experience. Now, we'll experiment with other pricing models not only for India, but around the world that allow us to sort of broaden access by providing a pricing tier that sits below our current lowest tier, and we'll see how that does in terms of being able to accelerate our growth and get more access. But even under the existing model, we feel like we have a long, long runway ahead of us in India.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

But maybe following up on something that Reed has talked about publicly in terms of the potential for growth in India longer term, how does the model have to morph to maybe line up with longer term goals of adding 100 million subscribers in a market like India?

A - Wilmot Reed Hastings

We'll have to see (00:07:43). We'll go from expanding beyond English into Hindi and then into many more languages, more pricing options, more bundling. All of those things are possible. There's over 300 million mobile phone subscriptions or households. There's almost twice that of mobile phone subscription. So, there's a huge market, and people in India like around the world love watching television. So, we'll take it 1 million at a time and figure out how to expand the market as we grow.

(00:08:19)

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Couple of hundred million people watching content through the Internet in India, so really an exciting idea.

A - David B. Wells {BIO 17034721 <GO>}

And just to wrap that, Eric, in terms of investor expectations, Reed's 1 million at a time, we're super encouraged with India and the growth that we've got early on. But we know it's going to be somewhat of a tough market, right. So, there's – that notion is along – is 1 million at a time, right. It's not going to be overnight where we're going to get to those higher numbers.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Is there any way to tease out – when you see subscriber growth internationally like you just published for Q3, obviously, an even bigger number as you forecast out to Q4, to tease out how much India is contributing to that versus non-India? And are there any markets on either the content side or the subscriber side you'd like to call out ex-India?

A - Wilmot Reed Hastings

For competitive reasons, we're not going to give you too much color on that. What's driving the P&L progress is doing shows to carry in multiple territories, creating great synergy around those, great excitement. And that's why we really – we hardly look at it U.S. and internationally when we look at it internally, almost all just globally.

A - Spencer Wang {BIO 3251222 <GO>}

And, Eric, as you probably saw in the investor letter, we talked about the growth in our membership has been very broad based and very global. So, I think you should read that as what we've said in the past, which is the phenomenon of Internet entertainment is really a global phenomenon that we're benefiting from.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Fair enough. One of the things, shifting a little bit further down the P&L into revenue, international saw some headwinds from FX this quarter. Understand the translation issues around that, but wanted to understand if that volatility is causing any headwinds or tailwinds you're seeing in terms of end demand for the product or consumption of the product or is it purely a translation issue?

A - David B. Wells {BIO 17034721 <GO>}

It's mostly a translation issue. Absent foreign exchange, our ASP – international ASP would have grown. So, I don't think we see any demand effect from foreign exchange.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Fair enough. Maybe two bigger picture questions. One that came in a lot of formats from people ahead of the call, competition. As you look out to 2019, I know not within the forecast period, but as you think about how the competitive landscape might shift, where the market is going from a global standpoint on the competitive standpoint. How do you think about some of the friction points you're trying to solve for as a company when you look out at that competitive landscape?

A - Wilmot Reed Hastings

There are so many competitors. Of course, Disney is going to enter. AT&T is going to expand, HBO. YouTube is just on fire growing around the world. Video gaming like Fortnite. There's so many ways to have great entertainment on the screen. So, we don't focus that much on any one because no one seems to affect us that much. What affects us is can we produce the best content the world's ever seen, can we get people excited about that content, can we serve it up in ways that make it really fun and easy, again, focusing on our fundamentals. And some day, there will have to be competition for wallet share. We're not naïve about that. But it seems very far off from everything we've seen. So – and we're continuing to work with many of those firms where it makes sense to for both of us and it's creating a big and vibrant industry.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Maybe one follow-up to that directed at Ted. When you think about the competitive landscape and what it might mean for either acquiring, sourcing or partnering on content with people globally, Ted, how is that changing the conversations maybe as you look out over the medium to long-term? Where might we see some of the pressure points that competition could play out on the content side?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Well, we've been a pretty dependable buyer, and increasingly some of those sellers have been more complicated sellers, meaning there are conflicts within their companies of what they want to sell, when they want to sell, at what windows they would allow for – (00:12:26) to allow flexibility to offer their own services, which is something we foresaw years ago when we started doing original programming. But in the meantime, I think that they are – the studios, who always have been somewhat of potential competitors, have to look at those things today and say, what's the best way to get return on investment for creating great content. And in some cases, it's going to be launching it through their own direct-to-consumer initiatives. In other cases, it's going to be selling to Netflix, which has proved to be very positive for them for many years.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Can you talk a little bit about – maybe sticking with you, Ted, about some of the asks that are coming from content creators? We continue to hear as we talk to (00:13:06) people in the media industry about awards campaigns or marketing budgets put behind content. People want their content seen, who are content creators. How have some of those conversations changed? What might it mean for ways you go to market when you look out over the next couple of years in terms of taking content into the marketplace?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Well, I think what you said was perfect that people definitely want their content seen, and the best chance of doing that is doing it with Netflix. And you see in the long list of content brands and newly minted stars out of Netflix just this quarter, you can see what we're talking about, about putting content into the culture and into the Zeitgeist (00:13:44). And what's really great, it can get nominated and win Emmys or Oscars, and those are really important to filmmakers and creators, and we're super proud and happy for them when they win.

But in general, what we want to do is try to make great content, elevated to the right audience in the most efficient way possible, so we could do more of it. And what we've seen more is that these shows that come out on Netflix are really piercing the culture. Some of the most watched shows in television are on Netflix and the creators know that. So, when they – the asks that are coming in the (00:14:15) forms of marketing campaigns and awards campaigns, they're seeing that in very big numbers from us anyway. We had 40 shows nominated for Emmys this year and became the – tied with HBO for the most Emmy wins this year. And that comes with great content and great campaigns, both marketing and awards campaigns.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Maybe two follow-ups here, the first one on the product side. The team has talked before about lowering the friction to consumers finding product. That seems like a bit of a machine learning/product development issue that you have to solve for friction points as you look out over the next couple of years. How should investors think about lowering friction to consumers finding content? What are some of those key investments that are being made? How those investments might change in the next couple of years?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Again, I would draw your attention to the letter, that list gave some very specific examples of people who went from being completely unknown to being global superstars in the span of a few weeks or a few months of this quarter alone. So, I think that it's evident that things are being found at an incredible pace on Netflix versus getting lost in the sea of things on Netflix.

A - Gregory K. Peters {BIO 17539678 <GO>}

And our job is to make that even more over the years to come, and so we're investing in a variety of different dimensions. The one you mentioned, but in terms of the design of the UX that we have, the user experience. Just this quarter, we released an upgrade to our TV UI navigation that allows users to be a little bit more specific in terms of the content that they are looking to browse through. So, imagine it's Friday night, you want an engaging movie. You can tell us that and then we'll present the recommendations and suggestions that we have of some of our growing impressive film titles that you can really immerse yourself into. And that's just one of a line of multiple product updates that we anticipate having that we think will magnify that effect that Ted is talking about, about incredible content being discovered in the show and then becoming a big social phenomena.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Bigger theme that maybe I wanted to talk about was alternative content. There was a partnership announced with SiriusXM. How you're thinking about new forms of content to be distributed on Netflix as you look out over the next couple of years? What are some of those things you think your consumer is asking for that reduces churn, gives you more pricing power, gives you a higher ROI against some of the investments you're making? Would love to sort of tee that up broadly for the group.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Well, in the case of the SiriusXM, that is a – looking for kind of a marketing synergy for our stand-up comedy initiative, being able to have bites – bites of our stand-up comedy specials that are otherwise only available on Netflix in their entire run as a way to entertain fans of stand-up comedy and discover new talent. And that's just something – an (00:17:02) ongoing part of our overall initiative. It's a pretty – it's a small test right now to see how that goes, putting up clips and interviews and interview shows featuring our talent and supporting our talent. So, think about it as a different way of marketing the existing program that we're doing when you're not on Netflix, when you're more likely in your car – when you shouldn't be on Netflix in your car.

A - Wilmot Reed Hastings

So, Eric, per Ted's comment, we're not really focused on the monetization of those efforts. It's really around deepening the brand connection, which ultimately monetizes as faster growth for us. So, all of our auxiliary efforts are not around creating additional profit streams for now. They're really aimed around strengthening these mega titles, because that's what drives the business. And a little bit incremental growth is much more profitable for us than creating separate businesses. So, we're always evaluating them on do they help the core, do they help that love of the new stand-ups.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Maybe continuing to move through some of the costs in the business model, marketing has been a heavily debated topic with investors. As we've gone through the last year, saw a pretty big change from the over 90% growth in marketing you saw in Q2 to something much lower in Q3. I think prior management's called out the idea that marketing would be sort of in a test-and-learn mode this year, maybe pivoting away from just pure subscriber acquisition. So, a couple of questions. Number one, what have you learned in some of the changes you made about marketing this year? And how do you think that might inform how you go to market as a company going forward, both for subscriber growth and then support on the content side?

A - Wilmot Reed Hastings

Ted, do you want to take that?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Yeah. I would say that one thing that we've learned as we've gotten along, there was a time when we didn't market any of our content. We spent all of our marketing effort just talking about Netflix and how to use it. And today, we find is that selling House of Cards in its final season is really all about selling Netflix. So, what we're learning more and more is that yes, we can drive some viewing up and down. Yes, we could draw, but that's all mostly centered around getting people excited about watching a show that's only on Netflix because it's a great thing for Netflix and how to sell the service. So, that gives us – and we do it over many titles because people's tastes are very different, and being able to aggregate people to talk about the same things, watch the same things at roughly the same time has got a lot of value. And we're still learning all the fine arts of that.

A - Spencer Wang {BIO 3251222 <GO>}

And, Eric, just sort of on the financial aspect of the marketing spend, some of that, as we called out in the letter, was sort of timing related and shifted a bit into Q4. So, that sort of dynamic that you highlighted isn't a signal on any sort of specific change in the strategy.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

And that would lead to maybe my next question. So, Spencer teed that one up for me. Thinking about the pacing cadence of investments in Q3 versus Q4, I thought there were some key learnings in the letter, but just want to give a little bit of an opportunity to frame what might have shifted out of Q3 and into Q4, how investors should think about that against some of the longer term investments you're trying to make in the business.

A - David B. Wells {BIO 17034721 <GO>}

It's either for Ted or – (00:20:10) I'll take the sort of marginal progression or the quarterly progression. I think we're balancing the steady growth of operating margin, but allowing the business to have the flexibility to choose sort of optimal release timing and promotional timing and create that flexibility for them. So, yes, next year, we see a little bit more steadier progression towards the 13% target that we have for the year. But I think we'll see some natural seasonality in terms of release – content releases, and maybe that's a pitch to Ted now to take the next part.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Yeah. We've really been trying to optimize on when is the best time for the content creators and for the fans to release that content. And sometimes they're regulated by outside forces and other times they're just trying to line up that perfect viewing time, and they try to lead with that, we end up with very happy members and very happy creators.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Following up on that – the comment from the letter about less quarterly variance, is that then just purely a function mostly of smoothed out marketing spend and the fact that you have such a scale of content that it's smoothed out more evenly over the year? Or is there anything you're doing actively to sort of create less seasonality or less volatility in the cost structure of the company as you look out into 2019 versus 2018?

A - David B. Wells {BIO 17034721 <GO>}

It's mostly the latter, Eric. So, we're not actively doing anything to the cost structure. We're just planning a little bit more in terms of the content and the associated promotion that goes with that, but it's a bit of a balance. We don't want to go too far with this either, because we again want to create that flexibility for the business, right. We're not optimizing for margin progression by quarter. We're optimizing for rolling 12-month growth of operating margin. But we're just indicating this year is a little bit unusual. We don't see as much pronounced lumpiness next year as we do this year.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

And maybe just one more on this, probably for you, David. The 13% plus or minus keeps up with sort of the pace you guys have talked about over the last couple of years of around 200 basis points to 300 basis points of margin expansion on a rolling forward basis. What are some of the things that could cause that number to arc upward or downward that you think people should keep in the front of their mind as the business continues to take investments from you (00:22:33)?

A - David B. Wells {BIO 17034721 <GO>}

The biggest one is foreign exchange in terms of, yes, on a mid-term to longer term basis, we use pricing to offset negative foreign exchange or dollar appreciation. But in the short-term, we don't immediately do that. And so, we can go through a couple of quarters where you're seeing foreign exchange affect both – just like this quarter where we had it affect international ASP. But on a mid to long-term basis, that should even out as we use pricing. So, foreign exchange is the big one. And then, growth, if we have more growth than we expected, that's going to drive more revenue and we'll get more of that in the back half of the year. But that can affect us as well. Those are the two big ones.

A - Wilmot Reed Hastings

If our content cost (00:23:18), there's a little bit of flexibility quarter-to-quarter, but not much. The marketing kind of has flexibility, but you really want to launch the title. So, it follows the content schedule and you can't shift it around trivially. So, then as David said, they're mostly top line factors between FX and revenue growth. The cost structure is pretty stable for next year.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

So, following up on that, Reed, and maybe for anyone who wanted to take it, you talked a little bit about free cash flow in the letter. The lower end of the range, a loss of about $3 billion this year and then possibly replicating that a loss of around $3 billion next year. One of the questions that came in to me in a variety of different forms was trying to size out either max free cash flow burn and what are some of the variables in the model that people should be focused on and max leverage that you'd be willing to take up in the business as you think out over the medium to long-term as well.

A - Wilmot Reed Hastings

Eric, you're using the word loss, and I think you mean investment. We definitely hope that they're not turning into losses. Our track record would show that those investments had turned out to be very successful for us. But I'll let David handle the question.

A - David B. Wells {BIO 17034721 <GO>}

Yeah. You took the immediate one that I was going to take but – so, thanks on that. Yeah, we're seeing those investments drive a lot of growth. So, there's a little bit of an attention to that from us. Eric, the biggest thing is that we're approaching – Netflix is approaching a point where the growth in operating profit is going to grow faster than our growth in content cash spend. And that's really going to drive the free cash flow towards improvement. It'll eventually breakeven.

I think what we said in the letter is flat with this year, and mainly that's because 12 to 18 months ago, we probably would have expected a little bit of a steeper peak and then a reduction. What's happened is content timing has kind of shifted back. We're growing faster, so we're investing some more of that into content. And so, you get sort of a flattening of the trend forward, but we expect material improvements in 2020. We still think it's going to be a few years towards breakeven, because we're optimizing again for long-term cash flow and long-term profitability, and we think that's the right thing.

And then, in terms of peak leverage, I think what you're going to see is at least electively funding our content, that leverage ratio is going to start to improve. But we're also looking at optimal weighted average cost of capital, which we've already discussed and indicated that would be based on about a 20%, 25% leverage to market cap ratios, where we think the long-term optimal cost of capital ought to be. And so, once we push past a point where we're more secure and we're – it's less about funding the immediate working capital needs of the business, we'll turn over or shift to thinking about long-term optimal cost of capital.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

One of the key themes in the shareholder letter was you've bucketed three different forms of content. Number one and number two were licensed and number three clearly was original owned and operated with a theme, I thought, of preference for bucket three to be the driver for the business over the medium to long-term. As you think about some of your partners maybe pulling content off the platform in 2019 that's been talked a lot about publicly, how do you think about either replacing that content from a volume standpoint or just redoubling your efforts around marketing and increasing ROI around existing content and scaling against your own original content plans rather than thinking about those licensed buckets?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Well, I'd tell you, going back just a few years, that since we started entering our original programming, what we've turned out is, is that our own original shows tend to be more valuable than licensing someone else's shows in later windows and the kind of the shared window model versus the purely original model. So, when we invest in original show, we find that we're having a better payback in terms of people watching and appreciating Netflix and valuing their subscription. So, that's why we're leaning in that way.

We have a variety of models in which we use to get content. So, what we really want to do is focus on what is the best programming. So, we get to be a little business model agnostic about if we don't own the IP, then we want to figure how to make that deal with the people who do. In some cases, they produce that for us in the first window. In some case, they produce that for their own networks and we license it in the second window. That will continue. But what we're pointing out in the letter is there's been a big – we are driving a lot of programming through our owned and produced originals that we're producing in-house, some of our biggest brands like Stranger Things are owned and produced in-house, and yet we're still licensing a lot of original programming from our partners as well.

In terms of backfilling things that are coming off the site, one of the better examples we think of how it could work well for us has been in our unscripted initiative, which last year we had no unscripted original programming on Netflix, and this year, about half of our weighted (00:28:30) watching of unscripted programming are Netflix originals. And therefore, the benefits of – and at about the same cash outlay, but with much more efficiency, meaning people are watching them in greater numbers for the same dollars spent. And with that, we have much steadier access to programming and we're building brands that people associate with Netflix like Queer Eye and Fastest Car and Nailed It! and Sugar Rush. These are all shows that people really love in enormous numbers around the world, and we don't have to go through the gun to your head renegotiation every couple of years for them.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Ted, you had some good examples before per region like Bodyguard and Sherlock. So, maybe (00:29:08).

A - Theodore A. Sarandos {BIO 4812832 <GO>}

That's right (00:29:09). We announced yesterday a co-production with – on Sherlock – I'm sorry, not Sherlock, Dracula from the makers of Sherlock with Steve Moffat as an – we would love to make more and more content with Steve Moffat. His deal is with the BBC, and we get to be partners with them to make this great show Dracula available around the world and in a fast follow model in the UK. And we'll do a lot more of that. Bodyguard is coming up in a few weeks and it's been a tremendous hit in the UK. We came in very early in that financially and creatively, and we think they've made a much bigger and better show because of it. And we think we could be great partners with local public broadcasters and networks around the world.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Maybe following up on that, because that's both a local as well as a global content sort of comment, how do you think about the ROI of local content and what it can do when it goes global and acts as a stimulant for the platform in a much broader framework than maybe it was originally planned for?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Well, what's super amazing about that to-date has been that these local language shows have been incredibly relevant in their home country and then they work very well in their region, and then when they really connect, they play multi-regional and sometimes completely global. And we have enough subscribers in the different territories today that we can have a real global hit in – without much viewing in the U.S. or with a lot of viewing in Latin America and the U.S. but not in Europe. So, we're seeing a lot of those things that are benefit of scale, obviously, but also picking great storytellers who tell stories that people want to hear around the world. And what we have found is that a good story well-told works, and it works in almost any language. So, as long as we focus on the quality of production, those shows can be worked to drive local subscribers in country, but also drive global viewing when we do it right.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Maybe one more follow-up on the content side for you, Ted. The film side, obviously, been a big push for the company. There's now been multiple efforts that have gone out to the marketplace. What have you learned? What are some of the friction points you're still trying to solve for in terms of both go-to-market and partnering with the right content creators on the film side? And how do you think about what that does for the platform again medium to long term?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Well, we've been thrilled just recently, we're releasing original films on Netflix from really A-list directors like Alfonso Cuarón and Susanne Bier (00:31:33), the Coen Brothers, Tamara Jenkins, and these are people who've made movies for the – directly to the theater their entire careers and are now moving to producing more and more for Netflix, because what they're finding is, to your point earlier, they want their content to be seen. They want their film to be in the discussion, and they're able to do that on Netflix in ways they've never seen before.

Paul Greengrass film 22 July just came out a few days ago and millions of people are enjoying it all over the world in ways that he's never experienced for his films yet. And that'll roll into 2019 with big new films from Michael Bay and Martin Scorsese. And what we're finding is, is that people want their audience – their films to find an audience and that they're in a better position to do that with us than without us. And that's a really exciting position to be in for film lovers.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Maybe pivoting back to the product side of the equation, you've talked a lot in the last couple of calls about getting mobile right, not only short term, but as a stimulant for long-term growth. Reed referenced earlier, there's a lot of people that want to consume content especially mobile first as you think globally. What are some of those product developments we should be looking for that you are hearing that from consumers would either increase engagement or increase adoption of the platform that aren't there yet when you think about where mobile viewing of media content globally will go over the long term?

A - Gregory K. Peters {BIO 17539678 <GO>}

Yeah. I think we see an opportunity to improve almost every aspect of that product experience, but I'll just throw out a couple interesting ones. One is as a method of acquisition, and again, it's very consistent with what we talked about in terms of extending (00:33:14) the partnerships, the kind of partnerships we have with mobile operators, whether that's a bundle model like we just did our first bundle in Japan with the mobile operator KDDI. We've done a bunch of preloads with Verizon on their Android phones in the United States. So, we have just all these different ways which we can use that as a vehicle to bring more subscribers onto the service.

But there's also a great sort of subscriber experience component of it too, which is something that we're exploring more and more as – not only just the direct content enjoyment part of the experience, but things like previews and teasers and what's coming now and how can we sort of create a continuum of experience, which is not only that great directly engaged moment when you're watching that show you've been dying to watch, but also things that sort of lead up to that, which maybe don't take a 30- or a 45-minute viewing session, but you only got (00:34:06) 5 minutes, you're waiting in line and you can catch a preview of a show that you are excited to watch and maybe watch that when you get home later tonight. That's the kind of experience I think we really can invest in and see good returns from in the years to come.

A - Spencer Wang {BIO 3251222 <GO>}

Eric, I think we have time for one last question, please.

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Yeah. Maybe I'd love to end on a bigger picture question for Reed. Reed, I think you've seen other technology platforms like some of the other companies I cover diversify more as they become more mature and enter new areas. Netflix is still fairly focused on streaming media and pushing your message globally about adoption and creation of content. How do you think about staying focused on the business model you have today versus looking for areas for diversification as you go globally that can be put on top of the business model, especially the brand awareness and the technology platform you've built, as you look out globally over the long-term?

A - Wilmot Reed Hastings

Yeah. Think about it if you've got 5 to 10 years more growth in your current market, you're probably optimizing value to stay in your current market and strengthen. Eventually, your market may not be able to hold your growth ambitions. So, that happened to us in DVD. We couldn't stay in DVD forever. Of course, we diversified into streaming. So, we're open to those possibilities. But there is so much growth ahead that's possible in streaming video entertainment.

So, we're just going to focus on that for a very long time. Unfortunately, lots of other companies are also focusing on that. But that's going to make it exciting for us for the next few years, great for consumers, incredible for producers. There's never been so much TV and movies being created around the world. And so, the game is on. We're super excited about pleasing consumers as much as we possibly can, and someday many, many years from now we may need to diversify. But for now, it's focus on the core of those amazing title brands, and when you look at the content we have coming out this quarter and next year, we couldn't be more excited, we couldn't be more busy.

So, with that, let me thank everyone for participating in the call. Thank you, Eric, for conducting it. And look forward to talking with you all soon.
