Welcome to the Netflix Q3 2014 Earnings Call. I am David Wells, CFO. Joining me today on the company side is Reed Hastings, our CEO; and Ted Sarandos, our Chief Content Officer. Interviewing us on our results today will be Michael Nathanson from MoffettNathanson; and for his last time Doug Anmuth from JPMorgan. Doug will be – Doug will be handing the baton over to Mark Mahaney from RBC next quarter.

I think Michael, you have our first question. So I'll turn it over to Michael.

Question-and-Answer Session

Michael Nathanson – MoffettNathanson

That's right. Thanks, David. The first question is going to be to Reed. I think the obvious question to ask is given though the miss in subscribers this quarter in the U.S. and the slightly slower growth next quarter in the U.S. what gives you confidence that you're still on the middle part of the growth-curve and the s-curve, especially given the fact that you have a grandfather price increase couple of years down the road, so anything on that.

Reed Hastings

Sure, Michael. We added 3 million net subscribers in Q3, so about a million a month and then in Q4 we're forecasting 4 million. If you look just at the domestic side however, that's about 1 million and about 2 million in Q4. And we're hoping for big numbers, we're always working hard on that. But when you ask what's the confidence that were on the middle part we really have to feel our way along quarter-by-quarter as we improve the content.

And if you think about the general society, all moving to Internet TV like HBO's announcement today, there's a lot of feeling of just everyone is going there, not exactly sure the rate of transfer but Internet TV is going to be everything in a couple of years.

Douglas Anmuth – JPMorgan

And Reed, just to follow-up on that, why is 60 million to 90 million still the right number in the U.S. given what we saw out here in 3Q and what you're looking at for the fourth quarter?

Reed Hastings

Well, everything that we're seeing is completely consistent with the whole society, not only the U.S., but around the world is moving to Internet video and Internet television. And so I think it's completely consistent with what we're seeing. And we're seeing – we saw Starz a week ago announced that they are doing an Internet video service; we saw HBO; perhaps all the other providers over the coming weeks. And so think of all the big networks are moving to Internet video and it's just becoming a very large opportunity.

Michael Nathanson – MoffettNathanson

David, given that that revenues came in line, subscribers came in lighter in the U.S. was there a mix-shift amongst your pricing tiers in the third quarter?

David Wells

Not really. Before I jump into the question, I realized that I didn't provide the Safe Harbor statement. So we will be making forward-looking statements during this interview and actual results may vary. And there's your proof that it's – this is not a scripted interview.

So Michael, back to your question, in terms of really the revenue number, we sort of missed on the total subscriber line and there is a bit of a delay between the folks getting a 30-day free trial and the revenue coming in. So that would explain most of it. There is a little bit of a mix-shift in terms of ASP being slightly higher than we forecasted, but most of it was just because of the revenue having a little bit of a lag.

Douglas Anmuth – JPMorgan

Reed, can you talk about the strength of subscribers in the new Western European markets in 3Q, how they performed early on versus your expectations and then also how much do you know here about conversion rates as they're just coming off of their one-month free trials and how is that impacting your guidance for 4Q.

Reed Hastings

Well, we had a very successful launch. We've done numerous launches now starting in Canada four years ago, so we're getting better and better at it. We've got some of the fastest integration with MVPD set-tops that we've ever seen in the world. In the U.S., we still don't really have anything material. In the UK, it took us a year-and-a-half to get Virgin and we were able to announce Orange and Deutsche Telekom, and these are all going live shortly or just turned live or going live over the next couple of months.

So, really a great successful launch that portents well for us and that's built in to the guidance. So, we're feeling, I mean, just incredible about international when you think that from starting four years ago in Canada to – through to the Netherlands, so almost 40 countries, as a whole are now profitable, just an average of two or three years after starting. It's a great success and that's why we're continuing to invest so rapidly at international.

Michael Nathanson – MoffettNathanson

Okay. I have a two-parter for Reed and Ted on HBO GO. Today, the big news out of the Time Warner Investor Day was the announcement of an over-the-top service to be launched next year in the U.S. Two questions would be for Reed. What do you think the impact on competition will be as they start really pushing that product?

And for Ted, the take-away was they might start sourcing some of Time Warner's – they're putting Time Warner's content into HBO on kids and maybe on movies and TV shows, so talk about those two things.

Reed Hastings

Sure, absolutely on the consumer side it's one more channel. So already consumers subscribed to us, and Hulu, and Amazon, and they do pay-per-view, and they do DVD, and they do cable. So there are so many great sources of entertainment and consumers subscribe to many of these. So it's not much of a change in the direct competitive landscape.

We and HBO have completely different content. So I don't think it will be significant impact at the consumer level. As we bid for content, that's more significant and I'll turn that over to Ted.

Ted Sarandos

Yeah, I'd say similarly that HBO is another buyer in the market if they do choose to start licensing from, even from their sister companies. And different companies have different views of how they look to vertically integrate. But in this case, I think they're very, they have an established revenue model for that content, with buyers like Netflix and others that they will have to competitively bid in the market for.

Douglas Anmuth – JPMorgan

Reed, just following up on HBO GO and the competitive dynamic there, do you have a view on how it could be priced and distributed when it ultimately comes out?

Reed Hastings

In Nordics, they've competed with us since launch two years now with HBO Nordics and there they chose to price on top of our pricing. Now, that pricing is higher because the VAT and cost of living, so it's not definitely indicative. But they've been quite aggressive in the Nordics and we stayed well ahead.

Michael Nathanson – MoffettNathanson

It looks like this quarter, I'll throw to David, that the guidance provided on free subs in international markets missed our expectations and your expectations. What is going on there? How could free trial subs miss expectations?

David Wells

Well, there's a number of ways. We just didn't grow as much as we thought we were going to in terms of bringing folks in. So across a number of markets we were lighter versus our forecast than we expected. And you collect all of those markets together and you get to a point where you missed on the total number, but you made it on the paid number.

Reed Hastings

And when David talks about missing, remember that what we're providing is our internal forecast and we expect to miss pretty frequently. That's the mid-point to essentially and so we'll be a little above that, a little below that every quarter.

Douglas Anmuth – JPMorgan

And David, you called out in the letter basically that the increase in pricing may have had some impact in 3Q and perhaps a greater impact than you saw in the second quarter, perhaps, because Orange Is the New Black offset that. Beside pricing, is there anything else that you can point to in the U.S. in particular?

David Wells

Any given quarter, there's a number of swing factors involved. We said that was our leading indicator or leading factor in the quarter. The Home Depot breach certainly brought down some of our – put a number of people on payment-hold. But we felt like if we provided three or four more swing factors it felt a little bit like an excuse, so we didn't do that. But there are certainly other factors at play.

We had a strong comp last year with releasing Orange in July versus in Q2 of this year and we talked a little bit about that. We certainly saw some effects from the Home Depot breach and then there's two or three more of those that we could talk about, but they are minor compared to what we think is the major one.

Michael Nathanson – MoffettNathanson

Reed, we got a lot of questions about France versus Germany as markets. Can you – I know, it's early days, can you share us some information as what you are seeing on initial take-up rates or excitement around – in France and Germany for Netflix?

Reed Hastings

Yes, absolutely. I mean France and Germany are unique markets and so is Brazil a unique market and so is Norway. And now, we are over 45 of these unique markets. And every market we've been able to figure out over time, what's the right mix of content. And think of basic consumer behavior as they want control and they want Internet video, because they get to watch on any screen, they get to watch any time they want, they get to binge-watch.

Those are very universal values and so we're gaining increasing confidence that Netflix is highly relevant around the world and that's why we're just looking forward to continue to expand next year.

Douglas Anmuth – JPMorgan

And just following up Reed and perhaps Ted here as we talked about the International business, what percentage of content in new international markets is local? How do you know what the right level is here, and do you feel like you have enough currently in France and Germany?

Ted Sarandos

So, Doug, I'll jump in there. The – it's similarly places the other markets have been around 15% to 20% local and within others, with 80%, 85% being either Hollywood or other international content. We – one of our first indicator is that, we are getting the mix right is how many hours of viewing people are participating in? And in France and Germany, the viewing hours are quite healthy relative to all of our other launches. So we're finding – consumers are finding the things they want.

The tricky thing is figuring out is the local content something that people want in the long-term, because when we first get to a new market, I think people are mostly excited about those things that they didn't have access to before. So, Orange Is the New Black was by far the most watched show in both France and Germany and, in fact, all of the markets that we launched.

So it tells you that with all the differences in taste that they both – they all rallied around that show. I do think too that we're offering those markets unprecedented choice, not just in programming, but also in choice of language, where you can watch the show either in native language or subtitles or dubbed in local language, which is something that's not been available to consumers in those markets before.

Michael Nathanson – MoffettNathanson

David, in the press release today or the letter to shareholders, you mentioned that Canada is now at the same margin as the U.S. after four years. How different are the penetration rates between those markets, I know, you don't get into the actual rates. But how different are acceptance rates there and is that the threshold for profitability in terms of U.S. level profitability around the world?

David Wells

Well, you're right, we don't get into specifics. But the penetration – the rate of growth in any given market can be different. So the rate of growth between Canada, between Europe, between Latin America can be very different. But just reiterating in terms of the financial performance and the return on investment, in 2012, we spent nearly $400 million in terms of contribution loss on international. And what we were telling you today is that is now a positive number.

So, in little less than two years, we've made great progress. We think the international is a very good investment. So, some markets are going to take longer than others, the content maybe priced lower in those markets. So, the economics are very different market to market.

Douglas Anmuth – JPMorgan

David, you mentioned in the letter a little bit about the changes in the VAT in Europe that go into effect in 2015. Can you talk here about how those new rules will impact Netflix in Europe, and how much profit is at risk here, can you just perhaps quantify things beyond just talking qualitatively about?

David Wells

Sure. So Luxembourg had an arrangement with the EU, where if you were headquartered there, you could charge a 15% Luxembourg VAT rate. And VAT rates, they vary from Switzerland at 8% on the low end to the Nordic countries at 25% on the high end. So for us, we're talking about an internal cost change to Netflix, because we're not going to pass that along to the consumer of about 5% on average of Europe revenue. So some others rates are going from 15% to 25%, some of them are going from 15% to 19%, but a weighted average that you can sort of ballpark is about 5% of European revenue.

Michael Nathanson – MoffettNathanson

David or Reed, can you give us an update on 2015 international expansion plans, you've called out that you are going to keep opening up new markets, how should investors think about the speed of those openings in investments in 2015?

Reed Hastings

We're still sorting that out Michael, trying to figure out, which markets are most attractive and we'll have some announcements to make over the next year. If you look at our long-term strategy, we've been extremely consistent over the past three years, saying that, we're going to take all of our profits and put them into international expansion, because we see it as such a big opportunity. So think of that as the base case if we can move quickly enough, then we can deploy all of those profits in highly productive ways.

David Wells

And I would say to give you some sense of the magnitude, we peaked out of international loss at 105 million we guided in Q4 to a number that slightly lower than that. But in terms of the potential down the road, we certainly could see that level of investment.

Michael Nathanson – MoffettNathanson

Okay. Thank you.

Douglas Anmuth – JPMorgan

So following up on that Reed and then perhaps Dave as well, Reed, you recorded about a month ago saying that it would take three to five years for single country to get to break-even. And then also that it could take Europe five to ten years overall to the break-even, and then also that you want to be fully global including China. Can you help us sort these out, and in particular, do you still believe that international contribution margins can be comparable to U.S. margins in a more mature state?

Reed Hastings

Yes, we're making great progress on international. We gave you the proof point on Canada having gotten there; we're continuing to make progress in all those markets towards having a similar contribution to contribution profit to the U.S. and contribution margin, so feeling great about that. The three to five years is what we've seen in our experience, we'll see if future markets are slower or faster, there are some variations. And then overall, Europe picture is, because we keep adding new markets, so that's why that's our longer timeframe, because it's a cascade from the very beginning.

Douglas Anmuth – JPMorgan

And just to clarify on that, you still think that that's the right kind of timeframe for Europe overall cascading from the beginning?

Reed Hastings

Yes, there's nothing that's changed.

Michael Nathanson – MoffettNathanson

Ted, as you start buying rights like Gotham worldwide, you start seeing some markets like Australia acknowledge that you have the rights to Gotham in those markets. How do you balance the need to basically buy global rights with a desire to be more measured as you expand internationally?

Ted Sarandos

Well, the one thing that's been really encouraging Michael is that the content, there is a lot of our content choices have proven to be extremely global starting with all of our original series that, Orange Is the New Black and House of Cards have been huge successes in not just in Australia, but in China, I mean, all over the world.

So these buys bode well I think for future expansion in all territories. And the – right now, I believe we've hit kind of a financial tipping point, where we can move forward on buying up more territories than we're currently operating in versus playing catch-up, which we had been doing, licensing the territory or creating original series, and then several years later having to go back and either renegotiate for that series or not have it like we don't have House of Cards in some of our current expansion territories.

Douglas Anmuth – JPMorgan

David, just on international expansion, what do you think the best way is for the street to think about and model your future international markets? So meaning, if we don't know the exact markets in any given years, what is the reasonable expectation for the number of new broadband households that you would like to address over the next few years, obviously, there is big implications here for both subs and, of course, for the bottom line. And do you expect these international launches to continue to be more heavy in 3Q and 4Q, or more evenly spread out through the year?

David Wells

Well, I've given you some indication of sort of, at least, the financial magnitude, I don't think, we have an addressable broadband household target in mind when we think about the next wave of international expansion. There is a number of just execution elements that come into play, how many we think we can do successfully well at the same time or consecutively and certainly we're getting closer and closer as Ted talked about to a global right.

So in terms of the incremental cost associated with an international launch, we certainly are reflective in some of our produced content today of having a global right or close to a global right. So I would say, it's our intent to continue to rollout international. You've got some indication of magnitude on the financial side, and we intend to continue to pursue it, because it's been a great investment so far.

Michael Nathanson – MoffettNathanson

David, based on some of our analysis, I think other people feel the same way, it looks like you can add in new markets between 300 to 500 basis points of penetration in the first couple of years, is that consistent with your own data which you have and we're not been able to dig into?

David Wells

We don't provide that level of detail and specificity.

Reed Hastings

The one thing, David, that we said in as we do in the launch markets is that, it took in the U.S. seven years to get to about one-third of broadband households. And that in the developed markets, so not as much LATAM, but for Western Europe that we're targeting those kind of numbers getting to a third of households over seven years. So that would be consistent with the trajectory that you've just outlined Michael.

Michael Nathanson – MoffettNathanson

Okay. Thanks.

Douglas Anmuth – JPMorgan

All right. Let’s shift a little bit more toward content, so Ted, a couple big announcements recently certainly Crouching Tiger, Hidden Dragon and then also the Adam Sandler deal, I'll just hit on the latter, but can you talk more about how data influence the decision to do the four movie deal with Adam Sandler. Can you talk about his global appeal as well, and do you think there are other actors or actresses that could have similar appeal for Netflix going forward?

Ted Sarandos

Sure, Doug, the Adam Sandler decision was driven on by following market after market seeing Adam's films either from his deepest catalogue to his newest releases performing – outperforming not only performing their Box Office, but performing wonderfully in every territory defying conventional wisdom that America comedy doesn’t travel.

And more importantly, he really performs well in the Box Office in our key markets like Brazil, like Germany, like the UK, and his last movie was 60% international. So Adam is not only a proven 20-year star, I mean, he has a move that performs well in the Box Office every summer for 20 years. He is a real global superstar and we see that in the data and the more international we get, the more access we have to that data – those data points versus relying on conventional wisdom of generic thinking like that American comedians don’t travel so well. So we're really proud of the deal and we think that our subscribers are going to love having access to those movies immediately through this new deal.

Michael Nathanson – MoffettNathanson

Ted, you mentioned or the letter mentioned today that it’s more efficient for you to buy movies this way than buying in your Pay 1 window. Can you talk more about that, because it seems to me that you are a successful film producer, you want to use the windows to monetize all your consumer touch point, so why is it more efficient to do it this way versus Pay 1?

Ted Sarandos

Well, there is a couple of ways to think about it Michael, the main one is access to content that people want to watch. And I think this long protracted window model was fine before On-Demand was possible like consumers now expect to see content sooner or have access to content earlier windows in the formats that they want to watch. So in this case, we are talking about Netflix and the current pay model doesn’t deliver movies to us till about 10 months to a year after theatrical and in some cases nine years after theatrical over sitting behind someone else's deal. So if you look at a successful film and you roll up all the license fee – all the licensing fees in each territory, it is possible there is an economic trade off that you are paying less to produce the film than you are to license it, and this model to your point about, you want to split those of the windows. For us this is programming cost, not an individual P&L on each film.

Reed Hastings

And the broad point here is especially with Adam Sandler multi-movie deal, it’s establishing a sense in the subscribers of thrilled with Netflix, because I'm in the Adam Sandler I watch this and now the next movie and the next movie comes. So think of it with us playing with this idea of episodic and serialized, but now in the movie forum and seeing what kind of great brand allegiances we can create for Adam’s fans, that’s not everybody, but they are very identifiable. So I think it’s a very creative approach that Ted's pioneered here.

Douglas Anmuth – JPMorgan

And on that note with the Adam Sandler deals, Ted, can you just talk to us about how you would actually measure the success of these kind of partnerships given that you don’t have the traditional barometer of the Box Office to track here?

Ted Sarandos

Yes, I would think about the same way we look at the successes around original series or any of our license series relative to what you are paying, do you get this kind of three legs of success, with the viewing, the brand halo, and net subscriber additions based on access to the content.

I think that particularly and this one is, we try to be as consumer friendly as we can and I think the model here is telling us that consumers want access to those films sooner and that we could build them model that’s economically feasible to do it. But if the measure – the measure – you should think about measuring success the same way we do series and do people get excited about Netflix because of it. And I think as Reed pointed out, I'm as excited about this as I have been since we talked about House of Cards a couple of years ago, about the potential impact on the brand and the subscriber enthusiasm around it.

Michael Nathanson – MoffettNathanson

Ted, in the UK, we found some data that suggests that younger households are consuming a lot more Netflix than older households, penetration rates are higher. You mentioned in the letter that you had, I think 75 series, kids series with over 2 million views. Can you talk a little bit about what is that mean, is that over a week, is that over, what duration is that and is that globally. They're – those are active titles, titles that are currently being watched, and that's a domestic number and we want to point that out, because relative to other outlets for kids programming that's a pretty big number for those and particularly in that kind of volume. But those are domestic and you can think about the international and domestic split roughly similar to our subscriber base.

Michael Nathanson – MoffettNathanson

And – within what timeframe, is it on a monthly basis, is it qummed [ph] over time?

Reed Hastings

They are currently active titles and they are qummed for active titles.

Michael Nathanson – MoffettNathanson

Okay. Okay, thanks.

Douglas Anmuth – JPMorgan

And Ted, on Crouching Tiger, Hidden Dragon some of the major theatre-chains here have responded pretty negatively early on in terms of the day-and-date IMAX release and Netflix streaming plans. What happens to the economics of your film strategy if some of those major chains prevent IMAX from exhibiting the film?

Ted Sarandos

Very little economically, I mean, I think the key to it is we would like to give the consumers the choice to see a big film on a big screen. And Crouching Tiger, Hidden Dragon is not a direct-to-video low budget sequel, it's a big film. And it'd be fantastic to have the opportunity to see it on the IMAX screens at the same time and IMAX has made arrangements with us for that to happen. I think it's – as expected the theatre-chains reacted negatively publicly. But I think the really – the real story will unfold on August 28 when the film opens, when we see if it's on those screens or not.

Michael Nathanson – MoffettNathanson

Reed, in the past quarter, it looks like in Canada, a local tribunal, the CRTC was asking for some data regarding Netflix that you guys were not willing because of privacy to share. Are you worried that governments and regulators will start asking for even more disclosure and try to enforce more traditional regulatory pressures upon your business?

Reed Hastings

It’s super important that Netflix maintain a reputation with consumers for protecting privacy against a wide range of players. So you will see us be a really staunch ally of the consumer. Will there be conflict with certain government agencies that may over time; we are not seeking to have a fight. We are going to try to work well with everyone and certainly as an example in France, I think we really turned around what could have been a difficult situation into one that was quite positive. So we are getting better and better at those governments relation skills, where we don’t have to have a battle.

Ted Sarandos

It’s probably worth mentioning, Michael, in Canada producing Netflix content gets bigger in the animated space. We’re one of the largest employers in Canada for animation executives and there is – I think something on the magnitude of $140 million a year be important to the Canadian economy producing animation for Netflix. It’s pretty impressive.

Douglas Anmuth – JPMorgan

David, can you talk about just how the amortization of these newer movie deals are going to be recognized on the financial statements? And then just in particular, can you go into some detail? I know you talked about in the letter some, but just the dynamics around free cash flow and EPS as both a function of some of the heavier content investments and then also the international expansion as well?

David Wells

Sure. So I'll take the amortization question. In terms of how the movies will be amortized, they will be accelerated like our large original series are. And until we have more data to challenge that whether it should be faster or slower, we'll take that assumption that they’ll be accelerated.

And then your second question was on free cash flow relative to net income. So we put the graph in there to illustrate the separation that happened in Q3. We've been saying this for quite some time in terms of the pressures on cash being the expansion of content, including produced content as well as the international expansion, because it forces the loss lower.

So I would say, it’s still consistent when we talked about 1.2 to 1.3 ratio of cash outlaid to content P&L expense is still consistent. And if we spend $3 billion globally on content and growing, even taking the 1.2 or the 20% ratio that’s 600 million of cash laid out for content over and above the P&L

expense. So we expect these trends to be persistent and I think that we have 1.7 billion in cash. I think we're okay for the next few quarters, but we continually look at this and if we continue to expand both content and international as we expect to do, then you should continue to see some pressure on the cash – on the free cash flow.

Michael Nathanson – MoffettNathanson

Ted, can you talk a bit about off-network syndication? In the past quarter, you were able to license both Gotham and Blacklist a year after they aired on network television. Can you talk a bit about what changed in model and what's the cost of those types of purchases versus maybe library content?

David Wells

Yes, and there is other variants on the model like in January you will see a Better Call Saul, the Breaking Bad prequel that we will be licensing in all of our other territory. And a year after in the U.S. and Canada, and then in the first run every other territory we operate in. So we are super excited about that one too. And I look at it about as all these models are changing pretty rapidly there is multiple buyers in the market. So I think at any one piece of content, the bidding can get pretty intense, but overall, the content costs are pretty consistent on all these new models.

And I think operating in 50 different countries and being willing to operate in multiple windows, gives us a real advantage in the market, so we're excited about that.

Douglas Anmuth – JPMorgan

And Ted, there've been some comments in the press recently and I think coming from agencies essentially. They're really the foundation for the agencies in selling to a streaming service. Back-ends of course are typically their foundation, but selling to a streaming with a perpetual deal they wouldn't necessarily know where that back-end would come from if there may not be a second sale. Does that create a problem for you in buying content rights across all markets and do you see any push-back there?

Ted Sarandos

No, Doug. And just like every time you present to a new market and a new window and a new paradigm, you got to figure out how to make it work in the old world too. So I think in – these problems were contemplated back when HBO started doing original series before they had a DVD business, before they knew if they were going to syndicate, so I think those are all navigatible and had been navigated in the past and we're navigating them as well.

Michael Nathanson – MoffettNathanson

Reed, a question on Internet net-neutrality, one of the things we started with looking at broadband investment is if the interconnect fee is capped or protected or kept zero, how do investors in broadband plant recoup their investment if they can't charge interconnections or how does the Comcast investor or the PIPE investor think about returns on their investment if they can't charge for interconnection?

Reed Hastings

Well, the simple version is they collect revenue on the Internet from their customers and that pays for the network and we don't ask them to pay for our content and we don't think they should ask us to pay for their network. So that's the basis of the no fee interconnect.

Douglas Anmuth – JPMorgan

David, I think U.S. marketing spend was down about 5% year-over-year and more than 200 basis points as a percentage of revenue. Why spend fewer dollars in 3Q if the growth was slowing down and you're coming in below forecast and could this have hindered sub-growth and how should we think about that marketing dollar trend going forward?

David Wells

Well, I think back six, eight years ago, there was a much more direct connection between our marketing spend and our net-additions in terms of bidding on bounties for people to sign-up via click-through on an online ad. I don't think that's true anymore. So I don't think that whether our marketing spend is up 10% or down 10%. There is an immediate direct connection felt on our net addition growth. So when we look at our marketing spend, we look at a number of factors. We look at what content, what opportunities we have to spend against that in the quarter. We look at what our margin targets are. There's a number of things that go into that.

But I wouldn't say that that was a large influent on the – on sort of the year-on-year decline of growth that we saw in the U.S.

Michael Nathanson – MoffettNathanson

Reed, over the past weekend, our home which uses FiOS had a trouble getting on to Netflix which is a good problem to have. But I wonder, what does your research tell you about satisfaction levels when there is a buffering or connectivity issue and how does that get solved?

Reed Hastings

I'm surprised that you got an issue. Verizon's done a lot of investment over the past three months to get the average speeds up and what's remarkable is how quickly they've been able to expand the interconnect so that the average speeds for Verizon are now some of the highest in the United States, still not as high as many of the speeds in Europe but some of the highest in the U.S. So it should be very rare and I have to follow-up with you and we can take a look at the logs for your home if you're comfortable with that, and we'll see what was going on.

Maybe, one of the kids was doing some illegal downloading.

Michael Nathanson – MoffettNathanson

It's my problem.

Douglas Anmuth – JPMorgan

Reed, just in thinking about the U.S. versus international markets, can you compare and contrast some of the challenges with peering with interconnection and net-neutrality, especially in markets internationally where we may be seeing some consolidation? Do you see any elevated challenges in some of those new markets you might wish to go into in 2015 and beyond?

Reed Hastings

Outside the U.S. there's much more of a common regiment of settlement-free interconnect. The whole charging for interconnect is really an artifact of size. So Comcast is the biggest so they get to charge the most and then it goes down from there, so it's straight power dynamics as opposed to costs or anything like that. So it's a much friendlier climate outside the U.S. for settlement-free interconnect.

Michael Nathanson – MoffettNathanson

David, can you update us on foreign exchange? I know it's still early days and you guys are growing internationally, but is your cost base denominated for most part in U.S. dollars and is revenue base denominated internationals? How does currency affect you guys next year?

David Wells

It’s a mix, but it’s actually very quite small. It’s under $1 million of P&L effect. On sort of valuing the balance sheet items there’s a little bit more of an effect especially against the British pound. I would say there’s a mixture across it, so there’s some natural hedging that occurs, but right now it’s actually quite small in terms of an overall influence on our EPS and on our P&L.

Douglas Anmuth – JPMorgan

Reed, or perhaps, David, can you review economics just around how the through the middle kind of set-top box relationships work and perhaps talk a little bit about how some of these newer dynamics or relationships in Western Europe may be relative to earlier deals and some of the smaller stuff for example that you’ve had in the U.S.

Reed Hastings

Well, I think we’ll both tell you the same thing that, we can’t tell you much about those deals, that we’re comfortable with the economics. We’ve done lots of deals in the U.S., first with Xbox, then with PlayStation, Apple TV, et cetera. So we’ve been doing these kinds of deals for a long time.

Michael Nathanson – MoffettNathanson

Reed, as HBO starts building out in the U.S. you’ve had experience in the Nordic region where they’ve competed with you. Can you share a bit what you have learned within the Nordics and does it mean for overall television consumption in that market?

Reed Hastings

Yes, each market is unique. So, I think they’ve had some teething problems initially two years ago that they probably would not have in the U.S. I think they’ve been licensing broadly, they just licensed a number of Starz’s titles. So they’re willing to license beyond their core platform. They’ve done pretty well and we’ve done very well.

And what we’ve talked to when we talk to subscribers there is there really, if they’re in the content they subscribe to both services. So I really think we’re going to see this just really fun-coupled years with the two of us compete for the best content, the most Emmies, the subscriber growth. And many, many people will subscribe to both services. So we’re looking forward to that. We’re just excited that HBO is really in the game with the Internet. They’re the leader in their field. They’re well ahead of their peer-group. They’re ahead of the broadcast networks in this dimension so it’s exciting to see.

Douglas Anmuth – JPMorgan

David, you updated the U.S. margin outlook to the 200 basis points of expansion per year and getting up to 40% over five years, of course, after you hit 30% early next year. How do you get comfortable that you can still invest what you need to in content in the U.S. and also do that 40% longer term margin.

David Wells

Well, I think Ted would tell you that he take everything that we've given. But I think that even with the shift to the 200 it still allows for some pretty significant expansions of both licensed and produced content. So we feel pretty comfortable about the room for continued growth of the quality of the content. And I think it provides a little bit of discipline in terms of making sure that we spend that marginal dollar well. So I'd say that we're pretty comfortable on both senses.

Douglas Anmuth – JPMorgan

And any chance you want to share more on what sub-number that 40% implies five years down the line?

David Wells

It implies continued growth.

Reed Hastings

Michael and Doug, we should do one more question each and then we should wrap it up.

Michael Nathanson – MoffettNathanson

Okay. Thanks, Reed. I have one for Ted. I believe one of your content deals early on had a put option for a company to actually put shows to you. I wondered what do you think will happen to those – to that agreement longer term and should we expect some more of the show – a big bundle of shows put to you in the next one or two years?

Ted Sarandos

All those deals, especially the early deals are very organic and they've all been in various stages of renegotiation and extension and redefining. So there's nothing looming that's troubling in that way because remember they were mostly designed in the beginning to gain access to the content, not to try to avoid getting the content. So we're – there's nothing out there that we’re nervous about or concerned about in our existing deals about a put that could just looming out there.

Douglas Anmuth – JPMorgan

And Reed, a question that we frequently get still is on pricing. We obviously saw the small, what we thought was a small pricing change in 2Q, but perhaps had a bigger impact in the third quarter. Does that mean really as we look out over the next couple of years that you may not do anything in, in terms of pricing or do you think, still think that you’d look to experiment potentially, do things around tiering?

Reed Hastings

Well, we’d definitely be listening closely to our members and then as we add more and more great original content than I think were more valuable to consumers. So we’re seeing an adjustment period that’s this quarter, we’re learning how to do that. But over the long time consumers pay for value and it’s up to us to frontload that value. And boy, the slate of content that Ted has for next year, it’s, it’s really exciting and it kicks off with Marco Polo in early December.

With that, let me thank everybody for joining us on this call and look forward to catching up with all of you over the quarter. And special thanks to Doug for his year of service. So we’ll continue.