Welcome to the Netflix Q3 2016 Earnings Call. I am David Wells, CFO and joining me on the company side today is, Reed Hastings, our CEO and Ted Sarandos, our Chief Content Officer. Interviewing us will be Scott Devitt from Stifel, sorry Scott Devitt from Stifel and Ben Swinburne from Morgan Stanley. Ben is in his fourth interview before he passes the baton.

Before we get started, we will be making forward-looking statements. Actual results may vary. Ben, I think you have the first question, over to you.

Question-and-Answer Session

Q - Ben Swinburne

Thank you very much. Maybe we could start by focusing in on the international strength this quarter. Typically, I think you and your colleagues have downplayed the impact of originals, but in the letter you really called out the benefit on acquisitions from your original content, you noted Stranger Things and Narcos. Can you just shed some light on that? Why do you think those are having such an impact on gross adds today and any particular color on markets that might surprise us about where those originals are really driving the business?

Reed Hastings

Sure. If you look over the whole year we've generated 12 million net adds this year. Last year we generated 12 million net adds. So there's been remarkable steadiness measured over the three-quarter period. But if you look at any single quarter, were high, were low and I think what's happening is that when we have some big originals it indefinitely grows the business, but some of that is a pull forward from the natural underlying growth rate.

And so, like if in hindsight if we look back in Q1 we over interpreted that. In Q2 that we over interpreted a low, but it is actually quite steady over the midterm which is basically a fundamental organic growth of this on-demand Internet television. So think of it as it can affect the quarter a lot, it affects the year only a little that is as the total programming is better.

Ben Swinburne

Yes, and you mentioned that the churn I think globally was roughly in line with your expectations as you moved through the quarter. As we just think about the longer-term particularly next year there's probably some logic to say that your net adds could improve next year overall given you are not going to have this elevated, so how do you think about the impact of churn as we move into 2017 and do you have any expectations for price increases at this point?

Reed Hastings

Well, we definitely want to increase net adds, but when I look over the last three or four years at how steady they've been, how hard they've been to move up and similarly that they've been very steady, we're only probably going to be able to make a little progress on increasing year-over-year net adds next year. So, we're fundamentally in this growth cycle that's to do with the Internet, smart TV, people getting used to on-demand, all of those aspects. So we're continuing to make progress. I wouldn't get to the micro variables about this churn or that churn or this show. It's much more of a deep force that's changing the market as more and more people are getting used to Internet television.

David Wells

Yes Ben, if I might add, it's probably useful to talk about U.S. and international a little bit differently. The U.S. is a much older market in terms of our ability to improve that product and have more time. We've kind of settled into a rate of churn that's lower than some of our international markets. They get there over time, but I would say and this in terms of that conversation, we think that there's room left to improve the U.S. as we is that sort of un-grandfathering effect fades out over time. But outside the U.S. we will definitely have more opportunity to improve churn turnover time as we improved these products outside the U.S.

Ben Swinburne

And not to do my Lester Holt impression, but Reed to make you answer the question, do you have any expectation for price increases at this point that you could talk about?

Reed Hastings

No, we have no plans on price increases outside of an inflation adjustment that we do in Brazil on an annual which is the law there.

Ben Swinburne

Okay, thank you.

David Wells

Then to just followup on another part of Ben's question which was international over performance which markets actually ever performed to the extent that you can identify specific markets or even that it was some of the older markets that were over performing relative to new or otherwise.

Reed Hastings

For competitive reasons we're really not going to break out per country markets and results. I would say we're having broad success around international. We're continuing to make those investments. We've got a lot of room to go to improve the service. We mentioned the letter that we've only just now localized Poland and Turkey. That brings us up to 22 languages. YouTube is at 50. So we've got a long way to go in that localization effort.

David Wells

I'll just add on quick, the one of the really encouraging points was our big series that we had going on in the quarter, Luke Cage, Stranger Things, The Get Down, Narcos of course. The great thing is they performed proportionally well globally. So the content is traveling in a way that we'd hoped. Scott and Ben I would say it wasn't any one market, it's okay to talk about the fact that it was a very broad-based performance across multiple international markets so very broad.

Ben Swinburne

And then secondly, the quarterly volatility in the stock and the performance relative to your visibility three months out domestically and internationally, it certainly does seem to accelerate the growing process for folks like me that watch the business on a quarterly basis. And I was just wondering to the extent that Reed you just mentioned that the visibility into the business and the linearity and progression of subscriber growth on an annual basis seems to be more predictable. Is there any thought in terms of providing annual guidance as it relates to subscriber growth instead of quarterly guidance?

Reed Hastings

I'm not particularly, I think we can all see that it's time for me to apologize for the volatility again, this time it's in a good direction, but I think more and more investors are able to look at the multiyear picture and they see the patterns emerging and so then it will be less and less about our guidance.

I think the main thing about one year guidance is we probably don't have any more insights than investors do, whereas in the current quarter when we're two or three weeks into it we do have a little bit of an advantage, so that's why we do the current quarter guidance.

Ben Swinburne

Let me ask you Reed, or David about the X1 integration. Brian demoed it recently at a conference. It looks quite elegant. Do you expect this to be a meaningful contributor in the fourth quarter when you look at your domestic net adds and maybe stepping back Reed do you think these partnerships play a larger role over time in driving your business than they have may be historically?

Reed Hastings

Yes we sure hope so. I mean, it is rolling out this quarter. It's a really nice integration. Comcast users tend to be pretty advanced high income households, so many of them already have Netflix. But having it integrated to X1 will make it easier to use. Our increase is the word-of-mouth and all of these MVPD integrations they help just like being integrated in smart televisions. So think of it as the more devices we're in the easier it is to use, but there's no step function here because again most of those homes probably have Netflix already.

Ben Swinburne

And do you have any concerns at all that the consumer who accesses it through the X1 is not as deep in the Netflix universe from an experience perspective as they might be using it in the smart TV or an app because they are sort of navigating through the XFINITY guide that you, how do you get comfortable that that wasn't going to be a negative, net negative, we felt like it was offset by other positives?

Reed Hastings

Well, there are definitely concerns like that and on the same side and MVPD has concerns about putting on Netflix. You know they'll build more Netflix awareness and we have concerns that the UI, but ultimately where we get together is let's try to learn together what the customer really wants. And if we're thoughtful with each other and we're focused on the customer together, we're both going to be able to prosper. And then on the X1 specifically, when you click on say it's in the guide to the show it brings you into the Netflix user interface for showing you the show and then the post play kicks in where you've got the different followup shows that you could watch on Netflix.

David Wells

And Scott and Ben we have other partners that we've launched with Virgin and others that we've gotten sort of an early preview in terms of how the consumer interacts with the application and as long as we're able to continue to improve the attractiveness and the compellingness of the content and the experience of Netflix we feel like we're – it's a good partnership.

Reed Hastings

And the X1 is the most powerful CPU box we've ever seen in the MVPD space and so the percentage of streams that are HD and the UI is really spectacular. It's the best that we've ever seen.

Scott Devitt

Reed you mentioned no plans for pricing increasing in the near term, now that you've gone through the un-grandfathering which has created a level of consistency and pricing across the customer base, I'm wondering how you think about pricing increases in the future. It seems like with where the product is priced in the U.S. and internationally today that there's still quite a bit of room and just wondering philosophically how you think about acting on that over time?

Reed Hastings

Well, look we've had a great couple of years at these price points and there's a lot of competition entering the market. What we're focused on is just how do we increase value to the consumer by having more spectacular shows, so that people watch more of Netflix. And over time, that will take care of itself, but we don't want to get overconfident just because we've had a good couple of years here.

David Wells

And there's a small technical carve-out on Reed's answer in terms of we do have some territories in the world, countries of the world, changing their VAT or their GST laws and to the extent that we feel like that's a territory or a country-level response and we can pass that to the consumer, we may do that. It's just, we have a lot of different price points across the world at this point. So it's just a technical addition to Reed's answer.

Scott Devitt

And then David, back to you. In terms of the commentary about material profits, we're now closing in on 2017. You added some language in the shareholder letter about mature process, again, in 2017 and continuing to grow from there. Could you add any numbers to that in terms of what material profits actually means? How we should think about that next year and in coming years?

David Wells

Well, we added some numbers in Q3 and in our guide for Q4, so you're starting to see that operating margin grow and the operating profit and we're growing both revenue and operating margin. So you're starting to see that grow already, but it will grow more and more materially next year and forward.

So I think as we are able to reduce our international losses, we don't have another set of territories that we're launching next year. And as we're able to grow both margin and revenue in the U.S., you're seeing that lift out, but we'll have more specifics to say in Q1 in terms of providing some more guidance on that.

Ben Swinburne

Dave, let me just pick up on that since we're talking about sort of the financial outlook. It looks like this year I think you guys are guiding to about $1.5 billion of free cash burn, which is higher than we were before. I mean, we could talk about what's driving that variance?

And then as you look to next year, $6 billion of content amortization is a 20% growth rate year-on-year versus 50% this year. So we're seeing the content cost grow slow, yet if we look at content obligation, which are over a billion sequentially or your free cash flow guidance, I think it used to be similar next year to this year. The gap seems to be widening between amortization and cash, so maybe just talk about what's driving that, if I have that right?

David Wells

Yes a little bit right, correct, a few points in there, but I would say our former sort of guidance for free cash flow was around a negative $1 billion, $1.2 billion. Now we're saying $1.5 billion for this year. It's a little -it's uncertain next year what that number might be. But I'd be surprised if it grows on a quarterly basis. So I would say as we're able to raise operating income, we'll be able to fund more of that organically.

So we should be able to take more of that inside in terms of - and reduce our free cash flow. But I want to give some level room for the scale of the business. If we're successful and if we grow faster than we expect, then we could expand our content even more than what we consider we would do today. So there's a little bit of matching that to the scale growth of the business.

How successful we are, how big the business we are growing internationally. And I would say in terms of the commitment number that number is up to 14.2 from the 13s before. And that has a lot to do with the expansion of our originals, our licensed originals and our international. So we launched the Rest of the World in January this year.

e continue to add content to all of our international markets as well, so we're seeing that grow. I would expect that to somewhat moderate in the 18- to 24-month period as we go forward. We don't have another international launch to layer on to that. But we are expanding the business so you've got two forces that are sort of counteracting each other. But in terms of our…

Reed Hastings

Ted May be you can go through it a little bit when we do the self-produced content like Stranger Things, all the advantages to it for the business, despite the increased use of cash.

Ted Sarandos

Yes, absolutely. I think when we see something like Stranger Things come across, there's the Simple One, which is it doesn't come with the studio markup it's attached to it. That is just purely expenses not on screen and the other is much, much more flexibility in terms of the rights that we have and the rights – and how we contain to exploit and how we continue to maintain exclusivity, but we're not seeing the content against our wishes going to other markets in the syndication, in DVD and others.

And we're able to produce it at a very high-quality and also much more efficiently. So to the extent that we can do that, while it does require more cash up front to fund the development process versus a studio who'd take that on, we find it's a great trade-off for cash.

Reed Hastings

And to reconcile back to your question, some of that was already reflected in our forecasting and in our guidance. But I would say, as we get better and we sort of exercise that muscle of our own production, more of that is reflected in our pipeline. So you're seeing that number, that 1.2 number float up to up to 1.5.

Ben Swinburne

And Ted, there was a comment in the letter where you were talking about your recent acquisitions like Quantico and Designated Survivor. We've talked about ensuring early financing. So just kind of connect David's point, are you talking about providing early financing to studio partners in exchange for better windowing globally? Was that what that comment's related to that's impacting the free cash flow timing?

Ted Sarandos

Nothing that has been done to date. It's basically just setting the table, there's a bunch of other different ways that you can get involved as a production partner with our studio partners versus a second window buyer. And some of that would include securing financing rather than having the studios continue to pursue deficit finance models.

Scott Devitt

Got it. 600 hours of original content in 2016 is going through 1,000 hours in 2017. I think David, you recently said at a conference, that you're about 1/3 to 1/2 of the way to the 50-50 split between original and third-party content. Where would that 1,000 hours put you in 2017.

David Wells

Well, it's a combination of Ted and I, so I'll pass it to Ted in a second, but I would say, we don't have a target. The 50 - my comment about 50% was more sort of grounding people towards the earlier comments that we made about 20% or 30%. So I'd say we like what we see in terms of the engagement on our originals so we're continuing to expand them. And so we're going to keep growing that. We don't have a magic target there that we're trying to hit. It's more about continued expansion and that mix of our content, being more of originals and less of licensing, but we're still expanding both licensing content is still expanding. Ted, if you want to add to that?

Ted Sarandos

I will say, I would just say, to your point, the licensed business, while as a percentage of business will shrink as an absolute number it will continue to grow for the next couple of years. And there isn't a magic target to David's point. What we want to do this, have really great compelling and differentiated programming for our members and we there through original programming when we do it successfully. So we just want to keep steering the business that way.

Scott Devitt

And do you have any targets for the original content that is produced by your own studio in terms of the ratio that is ultimately produced by your own studio versus licensed originals?

Ted Sarandos

No, similarly, what we're trying not to do is get trapped in the business model to making creative choices, meaning that sometimes someone else owns the IP, and you want to do it right by the viewer by giving them great things to watch, and the only way to do that is do it through a third-party licensed deal. Our financial preference of course, is to produce it through our studios, and when that opportunity will continue to present itself, we're going to increasingly do that as well. But we're not locking into a formula of how much of the programming should be self-produced versus third-party license.

David Wells

Exactly.

Ben Swinburne

Ted, let's just stick with you here for a minute on the content side. Stranger Things and the Get Down, interesting content examples over the summer that got a lot of attention. I believe the Get Down was quite expensive. Didn't seem to get the same size audience as Stranger Things, which I believe was less expensive and attractive economics. Why when you look at the Get Down, is that a good investment for you given the ticket size? And I think you've renewed it for a second season, what is that doing for your business that people might be saying oh the popular price is missing?

Ted Sarandos

Well, it's still to come. It's the second half of the first season, so that's still coming up. We're excited about how it got started. Yes, it's an expensive piece of television, mostly because it's a very large-scale cinematic. The reason why films work around the world is that a kind of attractiveness. So we're still seeing how it's going to unfold for first season, and all of the shows land at a different level of noise in the press and probably depending on what circles you run in, whether or not your friends are talking about it. But we're really very excited about how the show's been performing, particularly in the quarter where we had four shows that turned out to be kind of big event programs for us.

Ben Swinburne

And you've commented before that sort of output deals and Pay 1 deals from a timing perspective are suboptimal, but at the same time, you said really nice things about Disney's product over the years and how they work on your platform. How is the Pay 1 deal performing versus expectations? Are you happy with it? I believe it is a relatively short term deals? You'd like to do more of over time with Disney?

Ted Sarandos

Yes, look I think it's - we expected it to be very popular content and it's turning out to be. So Zootopia was the first really high profile film to come through, and it's performing in huge numbers because it's great kids viewing, beyond being great movie viewing. And the Disney brand are different from any other studio can deliver that kind of tentpole kids programming that the family loves and as long as it continues to perform at those levels, we'd look to expand it with Disney. But I don't think any other studio really can match that output and match those economics and therefore deliver that viewing. So we're going to still look opportunistically. Our films are available for that window. But really continue to put energy behind our original film initiative as well.

Reed Hastings

And in some countries, we have the Disney movie output, Australia, Canada, U.S., but in other countries like in the U.K. we lost the bidding to Sky about two years ago. So it really varies by market. We're one of the bidders and we hope to over time, be one of the biggest bidders so they choose us, but it really does vary by market.

Ted Sarandos

Thank you.

Scott Devitt

Reed, it's been speculated in the media that downloading off-line viewing may become available on Netflix by the end of 2016. Can you provide any insights or clarity on that speculation?

Reed Hastings

Yes, well we said this year is we're open to it. It's something we're looking at. But we have nothing more specific to offer.

Scott Devitt

And then secondly, password sharing in the U.S., you have plans in place that limit that. Just interested still in the enforcement of password sharing in the U.S. in terms of limiting that currently and in the future and then similarly with VPN networks within the international business, your views of that in terms of accessing content outside of countries that have certain geographic rights?

Reed Hastings

Well, I think we've been very successful at finding technological ways of inhibiting the cross-border VPNs, which is roughly like I had mentioned, we didn't win the bidding for the Disney movies in the U.K. so it's clearly not fair to rule out our U.K. subscribers to watch the Disney movies from Canada to the U.S. And so we found with the help of the studio, some more technology that enforced their rights. We tried to get global rights for everything, like How To Get Away With Murder from ABC, because then it's available to everyone, which is clearly what consumers want. In terms of the - what was the other question you had?

Scott Devitt

Password sharing.

Reed Hastings

No plans on making any changes there. Password sharing is something you have to learn to live with because there's so much legitimate password sharing, like with sharing with your spouse, with your kids. So there's no bright line and we're doing fine as is.

Ben Swinburne

Reed, just sticking with the theme of Disney, Bob Iger made some interesting comments a couple of weeks ago, talking about how his bountiful group list of brands ABC, Pixar, Marvel, may not be enough in the future and that distribution, figuring out distribution was important. Do you have any reaction to that? Because it seemed to be aimed at over the top and he does have a relationship with Hulu, which is a potential – a competitor or may be a bigger competitor over time, but do you have any reactions to those comments?

Reed Hastings

No, I mean they have a great strategy. They've got Hulu. They've got the Major League Baseball initiative and they bought some of that. And then of course, they've got Disney Life, which they operate in a number of countries.

So it makes a ton of sense for them to be growing on the OTT side and to figure that out as it does for us to do content. And I think you'll see more - you saw CBS All Access in the last two years, really become a big focus for CBS. So it's just a continuation of that theme.

Ben Swinburne

And Ted, just somewhat related here, I realize this is a hypothetical, but access to content is a big debate for Netflix. And I'm curious if you thought being part of a larger media company would inhibit your ability to acquire content from others in the industry who are competitors to that kind of a company?

Ted Sarandos

Like I said in previous quarters, this kind of frenemy model has existed for decades in television where competing studios produce for one another constantly. And it's really the question I think that our suppliers want to make when they're making decisions around their expansion over the top is, can they make better returns selling to Netflix or building their own thing? And that's both a long-term and a short-term question and currently hypothetical.

Ben Swinburne

Right, thank you.

Scott Devitt

Reed, just following up on competitor comments, Jeff Bezos recently made a comment that possibly Amazon video could be the fourth pillar of Amazon's business and I was just wondering how you think about, you have such an extensive lead in this global build out. How do you think about Amazon long-term as a competitor and Mr. Bezos' comments there?

Reed Hastings

Well, we think about it as share of screen time. And when people are doing other things with their screens be they mobile or television screens, they're not doing Netflix. So Snapchat, YouTube, Facebook video, all of that is it takes a lot of hours, probably much more so than Amazon. But there are so many competitors out there for screen time than we win today. Such a small percentage of total screen time bit moves by specific competitors are unlikely to have a material effect.

What affects us is, can we continue to win affection? And that's through doing all of this incredible content through expanding globally, having all those rights be global eventually, so those are the things we're focused on.

Scott Devitt

Okay and David, you commented in the letter about going to market for acquiring more debt in the coming weeks. You also mentioned at a conference recently that you thought the business was under levered. You mentioned a 5%, I think debt to cap ratio. How do you think about debt longer-term in terms of what that looks like and how you think about it is it net debt-to-EBITDA or otherwise?

David Wells

Yes, my comments at the Goldman Sachs conference about a 20% debt rate or a long-term optimization and cost to capital. I don't think we're talking about by the end of the year, getting to a 20% leverage ratio. So just to talk about sort of a shorter term or a medium-term, we would be looking to raise as needed in terms of funding our content expansion. So we've been pretty clear along the year that we would go-to-market sometime this year to add a modest amount of debt to the balance sheet. And then do that on a recurring basis as needed to fund our content expansion.

So, over time though, we anticipate that we could get and would optimize our cost of capital up to a 20% leverage ratio. And we're talking about a debt to market cap at that point, but I think we will be closer to an EBITDA basis as well because the business is growing and operating income and EBITDA.

Ben Swinburne

David, you guys recently localized your first batch of Rest of World markets. I believe it was Poland and Turkey and it sounds like it's been successful in driving growth in those markets. I guess the obvious question would be, why not move faster on localization? You've got a lot of recent Rest of World launches. Is that a cost benefit analysis or human bandwidth sort of throttle? What is keeping you from moving quicker? And what's the right pace for us to think about 2017?

David Wells

Damn it, move faster, I think it's a quality abstract right? In terms of we want to make sure that we have an eye towards quality as well. We had a couple of rough blog entries about some of our localization and subtitling in some markets and we pay attention to those. So we're moving as quickly as we can, being methodical and thoughtful about those opportunities to localize. And yes, we are pleased with both Poland and Turkey in terms of those impacts.

It makes sense that people want to consume in their language and so it's not going to make sense to localize in a super small territory. But for the larger territories, it's going to make sense and then even for the medium-sized territories. We'll get there eventually. I think it's just a matter of sequencing.

Ben Swinburne

And just to come back to maybe more of the short-term. You had talked earlier this year, about Australia and New Zealand being a difficult comp, I do believe in Q2. You've called out in letter Q4 comp of Spain, Portugal, Italy. Is there any way to kind of put that fourth quarter comp and the second quarter comp in some kind of context, just maybe a thing in the order of magnitude?

David Wells

Well again, back to Reed's earlier comments about for competitive reasons we don't talk specifics about our markets and I probably wouldn't. But I would say that there is a harvesting of the NAND initially when we launched in the market. It is that first launch quarter that we tend to have higher net additions and then that moderates over time and just sort of a run rate that's a little bit more normalized. We have the same thing going on that we highlighted in Q1 where we have Rest of World in the first quarter of this year, was a large number. And when I look at Wall Street's estimates for Q1, they're higher I think they're not taking that into account, so we wanted to call that out so that folks had the benefit of anticipating that.

Ben Swinburne

Any other Wall Street estimates that you'd like to call out?

David Wells

Just growing operating income and just the fact that I think Q1 was a little high relative to our expectations.

Ben Swinburne

Got you, thank you.

Scott Devitt

Ted, as you look at localized content and new markets how easy or difficult is it to find the talent in those markets to produce the content? How successful have you been there? And along that same topic, how do you think about some of these newer markets in terms of how much of that content ultimately, will need to be localized to create that S-curve inflection in some of the markets that were launched in 2016?

Ted Sarandos

So, in terms of successes to date, Club de Cuervos our first Mexican original was quite successful and we're getting ready to bring out the second season. Marseille for our French customers, not only successful in France but successful throughout Europe and got a significant amount of watching in the United States subtitled and dubbed in English.

So we're continuing to push. It's not degrees of difficulty it is just a matter of understanding the production community and the local tastes and who's working and making great films in those markets in some cases and are anxious to make the migration to television that they've been seeing happening in the U.S. So it's difficult in terms of not being on the ground they're usually. But I think we're making trade-offs in terms of the company culture to travel our folks into territory, get to know the folks in the markets, work with the best and brightest filmmakers and television creators, and bring their shows to the global markets through Netflix.

And in terms of localizing for taste, in many parts of the world, U.S. content or English-speaking content localized into local languages has been incredibly successful. In some places where tastes run much more local like Japan, like India, we're certain that will take more of a local approach in terms of licensing and producing more local language content there as well. But I think over time that the taste will fall into line with the kind of desire to see the big spectacular shows that people are talking about around the world no matter where you are.

Scott Devitt

And maybe you can give us some color on [indiscernible] Cable Girls, in terms of being content that may spread beyond their home market?

Ted Sarandos

Yes absolutely, what we tried to do, we're producing, as to Reed's point, we're producing showing now, that are just going into production literally today called Dark in Germany. It is with quite a successful filmmaker whose films have traveled around the world. We've been in the business of buying though films from those filmmakers and making them travel around the world for years. So I think that will continue with the move into multi-episodic series as well.

So we get that scale advantage of being able to take a German show that the German audiences will be very excited about and we know that, that will expand throughout Europe and that we've been really great at finding audiences even in the U.S. in subtitles and dubs, which has been really a niche business for most people, but very mainstream numbers for us.

Scott Devitt

Going back to David's comment about the difficult first quarter comp internationally. You had 130 markets that launched at the beginning of 2016, so it's obvious what the comp issue is. But also in your business, you have that initial wave, but then you have things like localized content, awareness and other factors that actually drive as an example in the Latin American market that inflection that happened two to three years after the initial launch.

So as we look at 1Q 2017, and then think about the 130 new markets, how do we think about that initial bump relative to the potential of these new markets actually beginning to really kick in throughout the year in 2017?

David Wells

Well, as you say, they do - one is going positive in terms of growth and one is negative in terms of initial launch. And what I was trying to call out without actually providing our Q1 guidance in January was back in January of this year, which I tried to moderate the estimates or the expectations coming out of our global launch, we had a very successful launch. In Q1, we had a lot of demand associated with that launch that started moderating into Q2.

And I think people saw the success of Q1, and really raised their numbers in Q2and trying to get a little bit ahead of that in the sense that we had a very successful launch in Q1 of this year that is going to be very difficult to replicate. Some of that was pent-up demand and we're not going to be able to do that.

That's not to say that many of our other markets are growing in terms of growth. It's just right now, in terms of what we see that large launch is going to overwhelm some of the growth of the other markets. So we still like what we're seeing in those markets. We're growing year-on-year in some moderate.

We've had very different, a wide variety of results across markets. We've had markets that slowed down and then accelerate in growth. So if you abstract that I think the general trend is the world is embracing Internet television and we're riding on a very strong kind of tailwind of technological change. And that is definitely intact.

Scott Devitt

Thank you.

Ben Swinburne

David, any color on how the 2014 markets are ramping or at least France and Germany in particular, I think there has been some concern in the marketplace that France isn't going well, I think you closed an office there and in Germany Amazon seems to be doing quite well? So can you just talk about how the model may or may not be working in those 2014 markets?

David Wells

Let me disconnect one thing there, in terms that we did choose to consolidate some of our French staff into our Amsterdam staff, but that had nothing to do with the market whether the market was growing or not. That had everything to do with the synergy of communication and how the teams are working together.

And then in terms of the other markets gain we don’t say much specifically about our markets for competitive reasons, but you would have to take my earlier comment about the fact that we saw very broad sort of outperformance relative to expectations in this quarter or in Q3, that would be inclusive of those markets. So I think we're pleased with how things are going.

Ben Swinburne

Great, shifting gears back to you Ted, you hired, hope I am pronouncing this right, Bela Bajaria from NBC recently and one of her mandates is unscripted. So I'm just wondering is unscripted going from something that you have a couple of bets in, which is something more strategic for you when you think about 600 hours to 1,000, how much is unscripted driving growth? Is it a material part of the plan for next year, and why?

Ted Sarandos

It is not a material part for next year, but I imagine it could be a growth – it will be growing over the next several years. It's been – it's an area viewing that people around the world in joy. The content travels well. It is efficient to produce. The current sources of second window unscripted programming are under a great deal of pressure from the cable operators not to sell their content off of their own universe because many of the episodes seemed to be interchangeable.

So being able to have a good steady flow of high-quality unscripted program is something we want to focus on because I think we can do it well and efficiently and may be elevated in a way that it would travel even more than it does today.

Ben Swinburne

And just if I can follow up quickly on unscripted. It would seem to be not obvious for the on-demand binging consumption model. But maybe you've had some experience so far with some your talk stuff or your comedies that maybe suggested is, I don’t know what can you tell us about that?

Ted Sarandos

There is certainly some benefits from the scale off of those shows, but our ability to producing maybe we have a lot of data and a lot of not a lot of data and a lot of content that gets watched and what travels and what doesn't, what gets repeated and what doesn't and it gives us a higher degree of confidence today than we had a couple of years ago and our ability or even desire to produce at the space, but it is a segmented programming.

We keep opening up new segments of programming, the way we did with talk shows last year. The way we will in the first quarter with Ultimate BeastMaster, our first competition show. So we're pressing into some new areas of the business all the time to bring new, unique, elevated and differentiated program into our members.

Ben Swinburne

Thank you.

Scott Devitt

Reed, investors get caught up a lot in the 60 million to 90 million household number in the U.S. and as an indicator or predictor for success in international markets, overtime, if you can do it in the U.S., you can do it internationally, and if you can't, you can't. You're running a little north of 4 million subscribers in 2016 from 5 million in 2015. How do you think about that business in terms of the trajectory in over say, the next 1, 3, 5 years in terms of how many subs that you can put on the business in the U.S. on an annual basis?

Reed Hastings

You know we have to take it year-by-year. It depends on how well we execute. Do we have more Stranger Things where it breaks through and everyone feels like they got to get in, Luke Cage, Get Down, Narcos. We have a show coming The Crown that some of our most impressive television I have ever seen and so I think November 4, when you ask yourself about 60 million to 90 million, when you watch that show, it's going to seem quite achievable. But it's all hangs on how well we execute and we're just going to work really hard on that front.

Scott Devitt

And following along those lines in terms of the relevance of content to drive subscribers given that that's why subscribers watch the shows on Netflix, on a P&L basis anyway, the growth in content spend has begun to very much leverage relative to the growth in the digital revenue stream. And I’m just wondering, as we look at that in 2017 over 2016, and then 2018, 2019 and 2020, is that something that we can expect to continue into the future? Is there a point in time at some level of spend at which you think you've built a complete enough portfolio that, that leverage actually significantly accelerates?

Reed Hastings

No, we'll keep investing in growing the content spend even domestically for quite a long time. We see an ability to continue to please consumers with a wide range of content. And so I think if you're trying to model the business long-term, you should think of content and how it's viewed and brand love always continuing up in the U.S. and internationally for a long time. I mean, I'll take two more questions, one from each of you.

Ben Swinburne

Great, I know we beat un-grandfathering to death last quarter, but if I can come back one more time before I sign off. David, you had talked last quarter about elevated churn even among members that were not seeing a price increase. And I think this quarter you talked about churn being generally in line with expectations. I just want to see if you had any color on that piece the un-grandfathering noise continued to elevate churn?

And then I'll just ask my followup. On the fourth quarter, just want to confirm the only un-grandfathering that we have left is the $1cohort is that – is that accurate?

David Wells

It's accurate on the last one. We have some sort of older generation devices that are difficult to message as well, so I think that defines sort of the last few cohorts the people left. And then back to your sort of primarily question in terms of what did we see in the quarter relative to our expectations and relative to prior quarters and actuals? I would say, I mentioned earlier in the interview, that we still see some effect from the un-grandfathering. So there is a bit of an overhang from the price change. It's starting to fade, and we expect that to continue to fade but we do think there's opportunity to improve that going forward in terms of next year.

Ben Swinburne

Thank you.

Scott Devitt

Reed, last one an open-ended question. You've talked a lot historically about the opportunities in Internet TV and have been very right in terms of the direction that the industry has gone with where you're business is now, I was wondering if you can just share some updated views in terms of the way you think the industry progresses over the next 5, 10, 20 years in terms of what wins and what loses?

Reed Hastings

Well we generally think of the growth of Internet TV like the growth of the mobile phone, that is fixed line telephony was an amazing invention, 100 years of development and brought incredible benefits to society and the same thing is true with linear TV. It's been an amazing innovation, but the age of linear is starting to fade and it's going to be replaced by Internet. And those firms like the BBC or CBS, that's doing all access that's invest heavily, I think will move into the future on Internet consumption. I think you'll see Internet growth generally more broadband kind of fiber optic to every village and town.

Those general trend lines, the growth both of YouTube-type advertising supported services, Facebook video, Snapchat. So you're just going to see these new scenarios everywhere. And eventually, movies and TV shows will be global, ubiquitous, some amazing budgets. So I think you have to think big about the future. We're closing in on 100 million members, but I remind everyone at Netflix that Facebook and YouTube have 1 billion daily actives. And so, in many parts, we are just so small compared to those other Internet video firms and we have a lot of catch-up to do and that's again investing in our content and making it globally interesting and compelling which we're working on.

So there's a lot out there. But we only just have to take it year by year, and it's tremendous fun inventing the future.