Welcome to the Q2 2016 Netflix Earnings Call.

I am David Wells, CFO. I am joined today on the company side by our CEO, Reed Hastings and dialing in remotely are Chief Content Officer, Ted Sarandos.

Interviewing us today will be Ben Swinburne from Morgan Stanley and Scott Devitt from Stifel Nicolaus. And I think Ben, you have the first question.

## Question-and-Answer Session

## Q - Ben Swinburne

Yes, thank you. Reed, I am sure we're going to spend a lot of time on the quarter and the long-term outlook, but I wondering if you could just give us a sense what gives you confidence that the churn the shortfall in the quarter was really driven by confusion among members around the price increases or the un-grandfathering versus other factors for example content, or competition and any color you might have on voluntary versus non-voluntary churn. Anything you can help us put some color around what's happened versus your expectations.

## Reed Hastings

I'm getting a lot of echo, Ted may be you can mute or something. Let's see you asked a question why are we confident at this explanation. Well, the obvious explanations other than this are competition, which we're pretty confident is not a factor because we got this slight uptick in churn in multiple countries the same week and of course that's not a competitive signature including Canada where many of the other SVOD services don't operate as a separate set, Crave and Shomi that operate in Canada.

So that's why we're pretty confident it's not competition and then again if it was saturation, what we would be seeing is hit to gross ads more than we would in terms of churn.

So, other possible explanations were that we did something on our service, around that week, but we've looked at everything and the fact that it's coincident with that Google trend data we included really indicates that people don't like price increases, we know that.

It's a necessary phase for us to get through and then with the increased revenue, we're continuing to invest in better and better content. So that's what makes us feel very strong and positive about the long-term and that this is a short term phenomenon.

**Ben Swinburne**

And David just as a follow-up, when you put the third quarter guidance together, are you assuming that this churn throughout the entire base remains elevated or have you seen that initial April churn subside and really what we're looking at is just the impact from the -- on the actual un-grandfathering, which you talk about in the letter being in line with expectations?

**David Wells**

Ben, we're assuming that it persists. So we might be wrong on that in terms of it relenting a bit or gets better, but so far we've seen it sort of persist through the second quarter and into the early part of the third, so we're assuming that persists into Q3 and maybe into Q4 as we continue to un-grandfather.

And just a cautionary, the usual customary language I realize I sort of went straight to your question, but we will be making forward-looking statements in this call and actual results may vary, but we'll go back to our regular questions.

**Scott Devitt**

Thanks. This is Scott Devitt. Reed, just wondering if the effects of the un-grandfathering have any longer term ramifications in terms of how you think of pricing power on the platform globally?

**Reed Hastings**

Not at the time. We're continuing to improve the content, which is the fundamental driver of value for subscribers, how much they watch, how unique the content is, how exclusive it is. We're going to continue to improve and again with new members we haven't seen any effect we change prices to our 8, 10 and 12 last October and we've had a couple of quarters of great growth on the gross add side.

So I think this is really around change resistance, whatever the price is for something people don't like it to go up. But in terms of new members, which is most of what drives growth, the new pricing is working great.

**Scott Devitt**

And in terms of, for David, in terms of the timing the links that you provided to Google Trends, I think the uptick started the week of April 3, so as the 3rd for the '16 that pre-dated when you gave earnings last quarter, what was the response? Was it immediate in terms of the uptick in inquiry volume and interest or was it somewhat delayed.

**David Wells**

Well, let’s keep in mind Ben or Scott that the -- what we're talking about is a very small change, right, but because of the large base a small change can result in 300,000 subscribers, which is the miss that we had on domestic resulting, but we did see it, we’ve learned through in the past not to overreact to immediate trend changes.

So it was a swing factor when we were discussing Q2 and into Q3 even and trying to shift through what might affect us in the quarter. We saw a little bit of it, but it was very right before we set earnings and we were on this call three months ago.

And so we felt it was a small factor, but it did persist through the quarter and that’s one of the major driver of the lower year-on-year growth and also the lower growth versus expectations.

**Scott Devitt**

And just sticking on the theme for around churn with another question, David, what are you seeing with the un-grandfathering members as they face different pricing options? I know you tested a lot over the last couple of months, what are you seeing in terms of their choices and how does that impact your ARPU expectation and when should we -- when will the grandfathering process be finished in the U.S.? Is that something in the fourth quarter, any help there would be great.

**David Wells**

Yeah. It finishes in the fourth quarter. So it finishes about mid way through, toward the end of November and then in terms of their choices especially around planned mix whether they choose the high plan or the low plan, it’s as we expected.

So we continue to see folks choose the lower plan and some smaller increments in the higher plan and some increments. So, our expectations of ASP growth are still there about consistent.

What we're talking about is the population that it didn’t face an immediate grandfathering choice, that’s the part that was a bit of surprise to us and continues to persist.

**Scott Devitt**

And does any of your data suggest you're seeing anything interesting around members that were inactive or may be membership sharing as a result of the pricing changes?

**Reed Hastings**

No, on both counts, so.

**Scott Devitt**

Okay.

**Ben Swinburne**

And this question may have been addressed in the letter given that you gave un-grandfathering commentary around international as well, but would be interested if you could just talk through your expectations for existing markets versus new markets and where you beat and missed?

**David Wells**

Sure, let’s see. I would say that we -- the trend was across multiple markets and as we put in the letter, it was in markets that are more highly penetrated and less highly penetrated. That’s why we think it is about the sort of pricing talk that was affected, but in addition to that, we would say that our newer markets have an expectation of multiyear growth.

So, we know that we’ve got our work cut out for us and then we hit a point where we’re not adding on any new additional markets, but we are going to be seeing periods of accelerated growth and decelerated growth and we’ve seen that in the past for some markets pick up and then moderate and then pick up again and I think that’s what we saw in this quarter and forward.

We're indicating that we’ve got multi years, just like we have in Latin America to build that market to where it is, has taken us four or five years at this point to get it there.

**Scott Devitt**

And Reed you - I am sorry.

**Reed Hastings**

We’ve seen in new markets in Asia, Central Eastern Europe that’s significantly different from early Latin America. It paints a pretty similar picture at least for these first six months.

**Scott Devitt**

And Reed you reiterated the $60 million to $90 million in the U.S. We would be interested if you could add some color in terms of where you think the friction points are if its content portfolio, competition or those being the two most significant where you see sources of friction and what gives you confidence still in that range?

**Reed Hastings**

I don't think there really is any friction. Smart TVs are continuing to sell. Everyone is using Internet video and Internet television more and more. You see the rise of these virtual MVPDs. All of these things are building out the Internet ecosystem and I don't see why 10, 20 years from now, why every American household isn't subscribing to Netflix except for maybe competition.

So we've got to stay on our toes on that basis, but think about entertainment and pay television are pretty ubiquitous. So in the Internet video, that's a pretty big bet that's continuing to pay off. So you put those two forces together and that's why we feel so good about the long-term in this market.

**Scott Devitt**

I want to just ask a little bit more about the guidance David, last quarter you called out the comp versus Australia, which was I think a bigger one or a tougher one than we all understood, when you look at third quarter I think you have Japan and then fourth quarter Southern Europe, could you just maybe put those at least in relative context versus Q2, so we can think about what those headwinds may or may not look like?

**David Wells**

Sure. There is always a headwind when we've had a prior launch of a large market or a market like Australia where we saw strong initial uptake. In terms of that moderating, you've got a lot of pent-up demand that then sort of reverts to a more normal pattern over time.

That can take several quarters, it can take two quarters. We've seen different experiences by market. So I would say Japan was a pent-up market in some respects and then starts to moderate, so that does factor into the comp.

And some of our other markets maybe experiencing flat or even down year on growth, it's just a mixture across that, but like I said, we've seen markets that have decelerated then pickup again and accelerate.

So collectively across all of our basket of investments in markets, we think there is a large long-term opportunity that we're going to optimize against and we know that we've got work cut out for some of our newer markets, that will take time to get there.

**Scott Devitt**

And just want to ask you about the Olympics and where you're factoring that in or how you're factoring that into your guidance, you mentioned gross additions remain healthy, which at least to me sounds like flat to up, but I'll let you comment if you choose, are you assuming that impact the gross adds and if so, is it a U.S. phenomenon or a global phenomenon in the third quarter?

**David Wells**

It would be global and so back -- you're correctly surmising that gross adds, you can say roughly in line year-on-year and so with an assumption of a hit from the Olympics, which largely affects us in the past on gross adds where our new subscribers coming in, that's going to affect in terms of a year-over-year trend. We expect that to be a meaningful small, but still meaningful impact on the quarter, negative impact.

**Ben Swinburne**

You haven't announced the X1 the XFINITY deal with Comcast and was without a timeline. I was wondering if you could give any clarity in terms of timing and then more broadly how you think about MVPD in the U.S. as a driver of subscribers in the way that years ago getting on to consoles and other devices actually led to an acceleration in growth?

**Reed Hastings**

Sure. We're very excited about the X1 integration. It's scheduled for the second half of this year. So it will be between now and the end of the year and really we're focused on getting the integration points very smooth and the Comcast engineers are doing great work on it. So look for it later this year.

It will help modestly, again we're more penetrated than we were before. So I don't know that it has big breakthrough because many of those households, Comcast households now have a Smart TV or have a Roku, but it will certainly help and from a user perspective to just live on the Comcast remote and to be able to stay on that input as opposed to having the switch inputs is a great thing for them and then the integration I think you'll be pleased with. So all of those is one more positive force for us coming later this year.

**Ben Swinburne**

And then secondly maybe for Reed or Ted, the Disney deal is coming soon with content supposedly launching in September, how much of a factor is that in guidance; how significant do you think that content launches from Disney will be for the business?

**Ted Sarandos**

Well keep in mind they're U.S.-only, the deal and those films are I think they're very important for watching and distinguishing Netflix as a different destination for parents because we'll have all the Disney movies, all the Lucas Movies, all the Pixar Movies and which distinguishes us separately, but I think it's just great high quality watching, but the movies is there about 10 months old. So we don't expect them to drive a lot of new subscribers, but we do expect it to drive a lot of customer joy.

**Reed Hastings**

And they come in one at a time. So you don't get the whole load of movies for example that are coming on to Stars this summer. Those will stay with Stars for the 18-month window. So it will build up over the first 12 to 18 months.

**Ben Swinburne**

When we think about the next 12 to 18 months or 24 months for the company, it would seem that the Olympics as well as the un-grandfathering are to some extent onetime events. And so as we think about 2017, I know you guys don't give guidance out that far, but I'm just wondering if it makes sense to assume that churn, the churn impact from the stuff rolls off and maybe the churn continues to decline the way it has been organically over the last several years across the service, certainly at least if you're successful around the original programming.

I just want to give you opportunity to talk about what the business looks like as you come out of this multiple headwind period here over the next couple of quarters.

**Reed Hastings**

Well let's see, in the individual market we would expect it to be as you said, we would expect it to return to its normal patterns and it continue to improve, as we expand throughout Asia and Central Eastern Europe, the overall global may be a different number because those as new territories will be more high churn, but fundamentally I think your analysis is right, which is there is some short-term headwinds for this year.

And then looking at the broad growth of Internet television, which is continuing to be very positive and then that's offset by competitors getting better, but that hasn't seemed to affect us in any of these markets.

So, I wouldn't anticipate because all of the online competitors together we're competing against the linear hours and there are still so much linear hours to see that that there would be any material change competitively around the world.

**Ben Swinburne**

Great, and just on the rest of world markets, you mentioned I think Poland and Turkey in the letter, you also mentioned being economically prudent, maybe you can just spend a minute on how you're thinking about these localization efforts what that even means and why the pace is what it is for that part of the business here over the next couple of quarters.

**Reed Hastings**

Yeah, it's a small additional investment in any market to localize it's subtitling and some dubbing across thousands of titles. It's localizing the service the different apps and then it's doing local language marketing and so we're just taking our time one by one.

The whole advantage of going broad in January was to increase our rate of learning. So, we wouldn't have picked out Poland and Turkey in the absence of any knowledge, but now we can clearly see positive trends we're starting with those and we'll continue to roll out improvements in other markets again as we see that the content is forming a great match with the society and continuing to work on that content.

**David Wells**

And just around out Ben, Reed, some of the factors we could do partner deals in certain countries, we could do local payment options and so those are the ones that we're referring to or depend on the economic prudence like the size of the opportunity in those areas.

**Scott Devitt**

Ted, you've previously given aspiration of mix of 50% original versus acquired content, could you talk a bit about where you feel you will be in 2016 and whether 50-50 for the right next long term.

**Ted Sarandos**

Long term, I think that's certainly a probable mix may be even a conservative one, but I think the growth of those original films, series, series for kids, documentaries, have proven to be great investments in terms of their efficiency relative to other high profile content that we license, which is encouraging us. I think it's made our rest of world launch possible by having content that people want to see in markets where we haven't yet operated.

And it certainly helps in terms of the complexity of global licensing. So we want to keep pushing it and we've also been able to manage very high quality at the same time of doing very high volume. So, we put in the letter but we've had 17 of our original film specials and series nominated for Emmy Awards, 54 Emmys this year.

So we've gotten and add 33 for our kids programming and we've been able to manage both volume and quality pretty well so, that's really encouraged us to keep pushing.

**Scott Devitt**

And it will be 600 hours of new content in 2016.

**Ted Sarandos**

Yeah, I expect that it will surpass that pretty comfortably.

**Scott Devitt**

We've thought about the business longer term in terms of how much content can you actually put on the service before you no longer need to add content. The question is as it relates to original specifically is that a fair way to think about it when trying to think through longer term content obligations?

**Ted Sarandos**

Yeah definitely. I think as we -- our appetite for licensing off net decreases with our appetite to increase our originals volume and as long as the customers are happy with the transition it encourages us to being aggressive in that space.

**David Wells**

And Scott, we’ve been able to expand our contribution margin in the U.S. and we intend to reduce international losses, which would imply that we’re able to grow revenue faster than our content spend internationally, but we would like to do both.

The advantage of our global distribution platform to the extent that we can find content that appeals broadly, there is an advantage and scale there in terms of distributing it. So we would love to continue to expand that content spend and also to drive some to profit as we go. We think we can do both.

**Reed Hastings**

And I would just add real quick, one of the most positive developments from our original programming has been today an original show from Netflix can be just as attractive as a show from any network in the United States, when licensing for territories around the world.

So it would lead you what we’re doing licensing first window for some titles in some countries and second window for global that we’re finding is this that when we're launching our new original series, there is a huge appetite for them around the world.

**David Wells**

And Scott I think it somewhat depends when you ask how much content is enough and whether you think of it as trying to attract a 100 million members where we’re now or whether you think of it as trying to attract a billion members like Facebook or YouTube are at today on the Internet.

So it just depends upon the size of your aspirations and as we accomplish one goal of course, our aspirations grow. So I think you’ll see content continuing to grow essentially forever.

**Scott Devitt**

Reed just going back to Internet TV as a segment and some of the initiatives there, how do you think about what we -- really think this new Hulu product is going to look like which is let’s just assume it’s the best of cable plus a fairly robust on-demand offering, how do you think that impacts your business in the U.S. one way or the other if they’re successful?

**Reed Hastings**

I don’t think -- well we haven’t seen impact from existing Hulu if there is a new cable system that’s better. Sling TV is in the market today and our penetration among Sling TV users is quite high. So think of that as cable getting better MVPD getting better and Hulu is a potential example of that, if the reports are correct.

**Scott Devitt**

And Ted when you think about your relationship with the owners of Hulu, particularly Disney who is a critical supplier of yours globally, are you worried that they're going to start making an effort to deliver more content to Hulu versus Netflix?

We noticed Disney did a deal for some kids programming during the second quarter and FOX has already made some pretty big shifts towards Hulu from an SVOD perspective. How do you feel about your relationship with those companies in the context of this Hulu launch?

**Ted Sarandos**

Well the relationship remain very strong. We continue to do business with every studio, every network in every territory. They're in the business of selling their content to the highest bidder. So I don't -- I'm not concerned that they would sell it for less to Hulu than they would to us because they have participation problems with the talent that they have to work through.

Now they've made a good position where if they really were to take that position and buy everybody out for everything that would meaningfully change the economics of those network studios. So I'm pretty confident that we're going to -- that it will be business as usual with the networks and studios.

**Scott Devitt**

Thank you. Ted, in terms of local originals understanding that every market will be different, can you talk a bit in terms of us trying to understand longer term profitability in international markets, how you think about local originals as a portion of the mix if you can take a few examples or paint a broader brush throughout the international platform?

**Ted Sarandos**

Well, we're in the very early goings of our international original life programming. We launched Marceau. We've launched original shows in Japan. We've launched in Mexico and we currently have productions going on in Germany, Spain, Italy, Korea, Japan, France, Brazil, Cambodia.

So we are producing around the world original programming and it really has an outsized impact in those first couple of shows because I think it does show those local markets that we’re investing in their production infrastructure, we're investing in their culture and taken, most importantly taking those shows and distributing them around the world.

So when we released a show like Ebana in Japan, people are watching Ebana all around the world at the exact same time, which makes us a very important part of the entertainment landscape in those countries and ultimately to those consumers as well.

**Scott Devitt**

And David you seen to have changed the language in terms of the 40% contribution margin by 2020 and adding possibly earlier as well, I know the trends over the intermediate term past have been trending better, can you just add some color to that comment?

**David Wells**

Well, I think it's just acknowledging that, like you just articulated that we were running ahead on that. So, we have to acknowledge reality that we may get there sooner than we -- then we initially targeted. I think for us broadening it back from just a quarterly performance of that progression towards U.S. contribution margin is the right amount to reinvest in the business.

We know that we want to drive efficiency. So we want some discipline there between profit and additional investment, but we also have to figure what’s the right amount of reinvestment in the business to maintain competitiveness both domestically and abroad.

And I think the U.S. business, I mention this in the past that to the extent that we produce an original for the globe, now that we’re in additional markets we're in more and more markets the U.S. P&L does receive some of that relief because there is a smaller share of that allocation going to the U.S. then there was before.

So some of those that was at play, that was in the past my team reminds me and nowadays the profit growth of the U.S. is being driven just by growing revenue faster than content, but I think those two things were at play in the last four to six quarters as we look at the trends. Thanks.

**Ben Swinburne**

Ted, just want to ask you to comment a little further on the market for acquired programming. I think there is a concern in the marketplace that its getting increasing competitive and expensive and I would love to hear how you see the market today, especially versus your expectations or your strategy around avoiding output deals and really finding stuff that's globally exclusive.

And maybe you can comment on the Amazon PBS deal as well as your own agreement with the CW of the StarTrek announcement today and also the Chuck Lorre announcement from a few weeks ago.

**Ted Sarandos**

Right, you covered a lot of ground there. So I may try to address some of them. As for the CW, the CW is a real anomaly in terms of a network. They happen to produce programming that has very consisted sensibility and a very consistent band base and that fits very nicely with a big viewing demographic and efforts.

We've got a great relationship with them. We opted to re-up that relationship even though it's a domestic-only and an output deal and we've individually licensed many of those shows for global distribution.

And we're thrilled to do that and not only to re-up our business, but also to move up the availability date of those shows to just eight days after their last episode airs versus having to wait until just before the new season launches.

So the fans of the CW programming are going to love that development. Then as far as the PBS Amazon, I would say we have so aggressively improved and expanded our original kids programming. In fact we have 35 different original kids programming, kids shows on Netflix, now many more in production in various forms of development.

So, more and more of that programming is leaning to our exclusive global programming and our regional programming in place of massive loads of content from other sources.

So our appetite for that meaning our appetite for high prices has gone down quite a bit and what else did I miss there? Star Trek, so Star Trek is an example of one that seems like an odd ball, because we don't have it in the U.S.

But this is one of those overhangs of regional licensing is that CBS was not making the U.S. available and we wanted to make sure that we could bring that show to the rest of our subscribers around the world. So, we're happy to premier the new Star Trek series all over the world outside of North America.

**Ben Swinburne**

Great. And I just want to may be pick up on the content, go ahead.

**Ted Sarandos**

Yes, you had mentioned also pricing and I've mentioned this before and I think it still holds true. You should think about content cost like player personnel cost. At any given season, a super star goes free agent and that particular player's prices goes to the roof, but player personnel cost, they remain pretty flat and that's the case here.

Every one's in a while there is a breakout very competitive title, and the price for that goes up, but the overall spend you have baked into our business model.

**Ben Swinburne**

Got it, and just following up on margins, David if you look at the international markets, which I realize is a portfolio, do you have a good sense for how much local programming you need in a given international market?

I realize there is a range and does that percentage impact the profitability of those markets long term? In other words if you need in a market like Germany half the content just to make something up needs to be German, does that mean that market is structurally lower margin and say the U.S. market or your broader portfolio or is it still too early to figure those things out?

**David Wells**

I think it's still too early. The dominant aspect that affects profitability in any one given market is the competitiveness and that can manifest itself in the competitiveness for content bidding. It can manifest itself for competitiveness of the consumer's moment of truth, how much they're viewing, where they're viewing, what are their alternative sources of entertainment.

So I would say that it's way too early. We've been very successful with an 80/20 model today and very disparate non-English markets in Chile, in Finland, in Netherlands and so we do have markets, early markets like Japan that are tilted a little bit more towards local content, but I don't think the margin characteristics are going to be necessarily determined by the percent of local as how competitive the market is.

**Ben Swinburne**

Thank you. Reed, time spent on the platform is such an important metric. I was wondering if you could update us just on time spent per user to the extent that there is anything there that's changed in either direction?

And then secondly, Sandvine, in their reports peak traffic showed a downtick and Netflix are still dominant, but little bit lower relative to peers in terms of the domination even from a compression technology during that period, can you just talk a little bit about how much of an effect that could have had on a metric like that?

**Reed Hastings**

Sure, I think on the Sandvine, which covers North America it might have been like 35% to 33% something like that, which would correlate very well with what we think was the increase in coding efficiency. So think of that as a flat result as opposed to a down result and then what was the first question?

**Ben Swinburne**

Just time spend per user, how that's trending? You've given periodic updates on that, I'm just wondering if there is anything?

**Reed Hastings**

Sure. Viewing overall is pretty seasonal. So you have to look at it on a year-over-year basis. But on a year-over-year basis, total viewing which is the fact that we sometimes releases up, forget you have the good numbers, but think of it as we were I think it was 13 million a quarter ago and it was maybe 10 million a year ago.

**Ted Sarandos**

Yes Scott. Sorry Reed, you did release those numbers at CES in January. So there was a data point there and I think that's what Reed was referring back to.

**Reed Hastings**

Total viewings continue to grow.

**Ben Swinburne**

Okay. And then secondly...

**Reed Hastings**

On a year-over-year basis.

**Ben Swinburne**

Great, download functionality which is a hot topic, some competitors have taken that on. You historically have suggested not interested and it seems like that's changed a little bit more recently. Can you talk about your interest there and then also cost implications in terms of contractual obligations.

**Reed Hastings**

Yes we're open minded about it as we've expanded it globally. It's something we've taken more of a look at given the strength of cellular networks not being a strong in some of the new markets. So that's gotten us to take a look at it and there is no material cost implications.

As you know some of our competitors in different markets in Germany, in the U.S. and others include a local cashing capability. So it's a pretty standard part of most deals.

**Ben Swinburne**

Question for David, just turning to the financials, that your remember growth fell short this quarter as you guys acknowledged in the letter, but your comments about profitability next year haven't changed.

If you think you expect substantial profits or material profits excuse me in 2017. Could you talk a little bit about the cash flow burn, cash burn outlook '16 and '17 David and any comment around P&L expense versus cash now that the top line at least seems to be growing a little more slowly than we all expected?

**David Wells**

Well cash flow despite all the perturbations of content coming in and out and the uncertainty around when that content might time has been relatively steady at about $0.25 million a quarter.

So I would say there has been no change from my understanding and expectation that it's about a 1 billion or 1.2 billion two in terms of the year and we expect that again going forward.

So free cash flow will improve when we drive more profit and start organically funding more of our content investment and in terms of the ratio of content cash to P&L, it’s still in that 1.3 to 1.4 range where it could peak up to 1.4, but it’s staying in that 1.3 to 1.4 range.

**Ben Swinburne**

Any color on the sequential increase on contract -- contractual obligations, I think it was 13.2 at the end of the quarter, how do you think about that number again given the context of a slowing little bit of lower top line, any thought?

**David Wells**

Well, content is one of those things where you invest, you don’t invest by quarter, you invest several years or years. So, I think what you're seeing is our investment in rest of world, the rest of world launch and the growth of additional territories.

You’re also seeing increased investment in some of our younger territories where they’re growing their content expense at a faster clip than some of our territories that are more highly penetrated or have been operating for more years, but just like Reed was saying that the offline viewing or the downloading rights aren’t really a factor. What you’re seeing is the growth of additional territory so, that’s what’s driving the content commitments.

And again I look at this periodically on a per member basis and it’s stayed in that bands and is consistent with prior trends and prior territory launches.

**Reed Hastings**

And you have to remember Scott, that when we look at it we’ve been doing this a long time. We've had these short quarters before. Nine years ago in 2007 we actually went down in subscriber. So, this quarter we're growing, but not as much as we want, but in 2007 we went down from 6.8 million to 6.7 million in this Q2, which is a generally seasonally tight quarter for us.

And it didn’t feel great going down, but now here we are at over $80 million. So, you just got to take a long term perspective and Internet TV is going to be an enormous market. We're very confident of that and our competitive position is very strong so those are the two fundamental things that give us confidence in the long term and want to us to continue to invest in more content.

**Ben Swinburne**

Thank you.

**Scott Devitt**

Any update David on the chip card transition to the extent there is still any remnant that you may have seen in the quarter from that?

**David Wells**

It's a small background as you -- it was back then that was -- became outsized because we pointed to it as one of the explanatory reasons that we had an involved churn uptick, but I would say it continues to be a small background issue.

**Scott Devitt**

And then for Ted, I don't know if there is a way to think of this that you've shared publically, but in terms of the product portfolio today and global rights that you have if you think of it may be relative to your spend, what portion of the portfolio has global rights associated with it and then secondly, as it relates to global rights, how are the allocations done between markets?

**Ted Sarandos**

So the allocations are done by media market share models and you should think about our global allocations as all of regional programming is fully global. Several, but we haven't broken out an exact percentage of our off-net licensees that we do on a global basis.

And then there is individual libraries from each of them, from each -- from around the world that we have global rights for of the lot of content that you may never have heard of, but actually get healthy niches of watching all over the world as well.

**Scott Devitt**

And Ted its right some of the content when we say global, that's global Netflix like sometimes it includes China, sometimes it doesn't. So, think of it as global to where we currently operate.

**Ted Sarandos**

And with the exception of our -- on the original side, which today it is always included China.

**Ben Swinburne**

Thanks. Yes, talk a little bit about how the Asian market rollouts have gone so far relative to your expectations and whether you're thinking about may be different price tiers or still sticking to the global price point as you look at the results there.

**Ted Sarandos**

Yeah, we thought about it and after launch and debated, do we want to try to be a low cost service like a $2 service or should we try to add content to make it a viable $10 service. And at least for the next few years, we're very much on the latter strategy. So we're going to invest to build a great $10 service.

We look at the iPhone 6s globally. We look at some other high value products and we want to be an incredible content service at this $10 price point rather than be very much lower cost or even free service and so that's what we're focused on as our current model.

**David Wells**

And then we already do have some price choices in our tiring. So, we do use the entry level tier as a mechanism for those folks that might be more value oriented. So, we do have some ability there to separate across price in terms of capturing those subscribers that might be more value oriented.

**Ben Swinburne**

And just sticking with the emerging theme, but markets you've been in a while, can you talk about the Latin American market and whether that continues to be strong and how you might think something like the second season of Narcos might results there.

**Reed Hastings**

Yes, go ahead.

**Ted Sarandos**

Yes Latin America has continued to grow well for us and what's been fascinating is the growth has been pretty steady even in Brazil where we see a significant recession and a difficult government situation.

So it seems that neither of those factors really affects a value-oriented business like ours. With the second season of Narcos, we're hoping to see great viewing throughout Latin America and throughout the world, but similar to our other originals.

**Reed Hastings**

That second season comes September 2 and it’s one of the things that we think we're very excited about the prospects of global television. We also have a new series we’re filming in Mexico Ingobernable and second season of Club de Cuervos in production.

So we’ve got a pretty healthy investment in Latin America, but I think that we’re at in emerging markets is exactly where we’re at in the first few months of the Latin American market, trying to figure out what those people in each of those countries love to watch and creating a service that is worth every penny of the subscription fees.

**Scott Devitt**

Thank you. Ben and I’ve -- both asked questions around cost structure and other components of the international business, I guess to try and gain understanding of longer term profitability, understanding differences in ARPU and content cost by country and local originals and things of that nature, is there a reason to think that international in aggregate shouldn’t have contribution margins that are similar to the U.S. over time?

**David Wells**

Well, I think each market will be different when you roll them up. I think structurally we can still get to where we’ve gotten to in the U.S. We demonstrated a Canadian proof point as well. It depends on whether you include them in that -- in that international bucket or not, but we do think that we can see across the system a variety, but if you average across it, we can get to those levels of profitability at least with the markets that we’ve seen today.

We may penetrate into deeper into markets that have much lower ARPUs that may have a different characteristic. So then it’s a choice of how big of a market do we want to address at that price point? Is that the bigger pie from a revenue profit perspective or we want to experiment down in the price to broaden the market and go after a bigger market at maybe a lower margin. I think we’re too early to tell on that latter case.

**Scott Devitt**

And then second question again for David and apologies if this was answered earlier but in terms of the un-grandfathering process, so where are you in the U.S. and then where are you in the international markets that you named in terms of customers that are going through that process having seen it at this point?

**David Wells**

Yes, I think in the letter we characterized it, but we're roughly halfway through and that will play out -- continue to play out over Q3 and into early Q4.

**Scott Devitt**

And that's consisting U.S. and those international markets?

**David Wells**

Correct. Now a point worth making here is that our international markets because they're newer, have more -- disproportionately more subscribers that are newer and already at the higher price points than the U.S. does, that's what makes the U.S. unique in this discussion.

**Ted Sarandos**

Let's wrap up with two more questions. Guys why don't you pick one each.

**Scott Devitt**

I just want to ask about Europe, especially the content you've been in a lot of these markets now for a couple of years, but I think they have been slow for either of you or all of you, what do you think you need to do in Continental Europe and Southern Europe to accelerate that growth and how much of it is content versus some of the payment stuff or anything else you might call out that you're working on?

**David Wells**

Well let's see, just to remind you in Spain and Italy, we only launched it last October. France and Germany was a year or so before that. And we've had really nice success in all of those markets with continued strong growth following the growth that we've seen for example in the U.K. or Canada, which will be the closest proxies in terms of wealthy markets with high pay-TV penetration.

So big competitor markets but we've got a solid game plan. We're growing in those markets. Payments are not an issue. So we feel very positive about those markets.

**Scott Devitt**

Thank you.

**Ben Swinburne**

Last one, Reed you mentioned payments, you've had payments as a source of friction in some earlier international launch markets, can you talk about that in the newer markets and what you're doing there to facilitate that?

**Reed Hastings**

Yes around the world eCommerce is unequally well developed. So in some markets there is very strong eCommerce payment platforms like the Netherlands. In other markets like Cambodia or Vietnam, it's challenging today we only accept international credit cards.

So we'll develop really along eCommerce in that whole ecosystem as people want pay for things online and that may come through mobile payments like Android and iOS, it will come along with third-party payment systems, but again the general economy and people are moving online through mobile and we're going to be able to take advantage and we are taking advantage of that.

So in the long-term, it's not a big friction point because everyone is going to want to be able to purchase many things including Netflix.

**Ben Swinburne**

Thank you.

**David Wells**

So thank you both and thank you to all of our investors. We apologize for the volatility. I know it's not easy on everyone. The big picture is very much intact and we're very excited about it and so we're continuing to execute on growing the business. Thank you very much.