Welcome to the Netflix Q2 2014 Earnings Interview. I am David Wells, CFO. I am joined today on the Company side by Reed Hastings, our CEO; and Ted Sarandos, our Chief Content Officer. Interviewing us today will once again be Doug Anmuth from JPMorgan and joining us today for the first time will be Michael Nathanson from MoffettNathanson who receives the baton from Rich Greenfield.

We will be making forward-looking statements today. Actual results may vary.

Our first question comes from Doug. So I'll turn it over to Doug.

Question-And-Answer Session

Doug Anmuth - JPMorgan

Great, thanks, David. Welcome, everybody, and thank you to Netflix for having Michael and me host today's conference call. So our first question, just on international strength, Reed, if you could talk about what drove the international strength in subscribers in Q2? You called out a couple things in particular, in terms of the Virgin deal, in terms of a set top box integration, and then also smart TV viewing in Latin America, so was hoping you could add a little bit more color on those, as well.

Reed Hastings

What we've seen really is just tremendous adoption of on-demand viewing consumers around the world whether it's Argentina, Brazil, Finland, the UK it's been really quite consistent. So there are some accelerators that we talked about with the Smart TV. But there is probably no better symbol of how strong is on-demand phenomena that to tell you that during the World Cup we were concerned that we would see a drop off around the world, particularly in Brazil and that we didn't want to over read it. If we saw a drop off in net adds and growth and what was incredible is just how straight our line of net addictions were in Brazil during the World Cup. And that's nothing I don't think that we're specifically doing, it's really this growing demand for control and for the consumer be able to click and watch what they want. And so that's why we're stepping up on the international expansion just because we really see that this is an enormous moment in history as on-demand Internet services are coming to the floor around the world.

Michael Nathanson - MoffettNathanson

David, can I ask you one on incremental margins. If we look at your margins in the first half of the year, you're growing your margins incrementally 45%, dropping down from revenues to margin to profits. Why don't you think margins can continue growing at the 400 basis point range that you saw and why did you identify different levels the 100, 200 and 400 basis point level of improvement. What control those potential margin levels?

David Wells

Well, Michael I don't know if I agree with your premise I don't think we said that margins will stop growing or will shift to 200. What we said is when we get to 30% we want to give ourselves a little bit of leeway to reevaluate. There is a number of things that we'll weigh and balance and that is the competitive set what we want to spend on content, how we want to grow that, how our average subscription price is growing with the recent price changes, it's still very early on those. So there are a number of things that will balance out. And we want to give ourselves a leeway to back-off a little bit if we think that's the right trade-off to make in terms of spinning more on content. It doesn't mean that we will, it just means that we're trying to create a little bit of room for ourselves especially with all of these unknowns as we get closer to next year.

Doug Anmuth - **JPMorgan**

Okay, thanks. And Reed, in the letter, you talked about the price changes having a minimal impact on growth overall, but can you just provide a little bit more color? Do you think, in terms of the nuances, did it impact churn, or help reduce churn in any way during the quarter? And what's your view on the way the price change could impact going forward?

Reed Hastings

I think we've seen really the impact of the price change go through already so it's pretty nominal, both in terms of acquisition which in principle becomes a little bit harder because of the roughly $1 higher prices, or in retention which could be a hair better from the grandfather subs. But it's only $1 difference. So, I really think it's background noise which is what we want it to be as we want to think of what we do is we're steadily improving the content and the growth in the word of mouth and that when we make a small change in price and handle it appropriately it really makes no noticeable effect in the business. So that's why we're thrilled with that outcome.

Michael Nathanson - MoffettNathanson

Okay. David, I wondered if looking your guidance for 3Q, would you have gotten to breakeven internationally in the third quarter if it wasn't for the new market launches and as we think about the growth rate and cost in the third quarter as sustainable into the fourth quarter internationally.

David Wells

So in terms of our international guide I think you can see that most of that is our new markets. So yes we would be pretty close to breakeven if not a breakeven for Q3 in our existing markets. And then the second part of your question was again, could you repeat that?

Michael Nathanson - MoffettNathanson

Well if you look at inflation in Q3 from let's say breakeven to where you're guiding to. Should we assume that continues to the fourth quarter, it seems a logical assumption that won't be a lot of change?

David Wells

I see what you mean. Well just to remind you that our launch is that we're saying are in the back half of the third quarter, so they are not a full quarter of content spending. Let me get that full quarter of content spending for the first time in Q4. So our typical pattern has been to grow content spend from the launch quarter. Marketing, it balloons a little bit in that first quarter of growth as we launch a brand new brand in those markets. Then it tends to settle down into a run rate and that should give you some trending on our international costs.

Doug Anmuth - **JPMorgan**

Great, and Ted, just perhaps one more question just related to Q2, and then we'll move on. Can you comment on Orange Is the New Black? You talked about in the letter how it became the most watched show in every country during Q2. Are there any other updates that you can provide around usage metrics, and then maybe talk about what you saw in Orange in Q2 perhaps versus the second season of House of Cards a quarter earlier?

Ted Sarandos

Well I think it continued the positive that we saw from House Of Cards, meaning that the excitement from the second season is amplified from like this show that people don't really know a lot about yet or in the case of House of Cards before we launched that no one even knew what a Netflix original series was going to be like. So here you have had a large pool of people around the world anxious for that second season. It starred in the Social Media Buzz that was really phenomenal for that launch. It gives us a lot of confidence for the outline seasons, the original series as well.

Michael Nathanson - MoffettNathanson

I have one for Ted and for Reed together. So last week FOX announced interest in acquiring Time Warner, two companies you know a lot about. If a merger were to occur, I think that would affect your negotiating leverage to get acquired and original programming. And this is a deal that you would block, Reed given the scale of the TV and film output from both companies.

Ted Sarandos

Michael I'd say that FOX and Warner are both pretty powerful companies today, particularly in the area of original production for television and film. So I don't know how that changes much in terms of coming together. Wouldn't want to make a lot of speculation about what's driving it. Probably there is a lot more to do with cable negotiations in sports than consolidating power reproduction. This is very difficult to corner the market on creativity or ideas. So I don't see how it's effecting too dramatically in these early days.

David Wells

And Michael I don't have any speculations for you on what we would do, there is not even a deal between those companies. So we'll take it as it comes, but as Ted said the more that we're working directly with producers the less vulnerable we are to aggregation in the big content suppliers.

Michael Nathanson - MoffettNathanson

And just following up there in terms of content and on studio related. Do you feel like you have the need to own your own studio production capabilities to protect yourself from some of the risks potentially associated with fewer production houses to buy from? Would you create your own studio from scratch perhaps would have made sense to the acquisitive in this area?

Ted Sarandos

I think a lot of it is tactical in terms of how you go about the production cost. Do you want to own the infrastructure versus hire it or rent it and you'll make those decisions as you go. There are probably some advantages, the intermodal and we'll keep exploring them as we own more and more of our production as we go forward. But think about it as the difference between renting sound stage time or owning the stage itself, it really depends on the volume of production you're planning to ramp up.

Michael Nathanson - MoffettNathanson

Reed can I shift you to the net new debate which I know you shared a lot already. But in your opinion what's the right regulatory approach for the U.S.? And should the FCC regulate the broadband industry as entitled to service. So I want to know if you could effect change of regulatory view, how would you do it.

David Wells

Well I think the most practical thing would be for the FCC to make it a merger condition policy of strong net new trial including no fee interconnect, so that's our main focus is around the merger acquisitions. In terms of the broad policy framework, it's tough in the U.S. because there doesn't seem to be much chance that the Congress will pass a new law and so then you've got some imperfect instruments in title 2 and section 706. So the fundamentals though is really for the FCC has the power in merger conditions and clearly there are going to be a lot of mergers to be able to institute our strong net trial. So we think that's the most pragmatic approach.

Michael Nathanson - MoffettNathanson

And just following up there Reed, last week in your comment letter to the FCC. You said that the Internet has had a cross roads and there is a risk of going down the path toward cable TV. Can you talk about what you mean there and a little bit more detail then and why you think the other road is better for the industry.

Reed Hastings

Sure in cable industry there has been constant conflict between the networks and the cable distributors leading to black outs and brown outs trying to figure out pricing. And we would hate to see ISPs brownout or blackout certain Internet sites in while they tried to extract payments. That just ruins the consumer experience this idea that when you sign up the Internet you can get everywhere. So, it's finding an industry structure that works for everybody, that allow there to be great investment and super high speed broadband but also a stable understood interconnect structure that then makes it able so that consumers can get all the services they want and those doing content services like ourselves and Hulu and others can innovate without the fear of being taxed, so that's why we're so big on the no fee interconnect.

Michael Nathanson - MoffettNathanson

Reed, its Michael. Following up on that is the media analyst here. I would say if you look at the power retrans is the content owner that has the power over the dump high. When I look at we are growing as a company, we're making more investments in original content and exclusive content you are the content owner. So why do you think you won't be able to, why don't you think you only have the power to force the pipes into putting the line wherever you want because you are the content to what I am subscribing to?

Reed Hastings

Sure. There is a lot of ways to think about and we do get asked in the cable business so for example HBO is our peer in the cable business they actually charge the distributor rather than pay the distributor. And so the question comes up, should we over time be charging ISVs for the privilege of carrying our data to their customers and charging for that. And again I don't think so, I think the Internet really has this different much more open architecture than classic cable where we need in the middle we bring the bits to where they want, we don't charge them, they don't charge us, both sides base very open structure and I think then you get more competitors for Netflix frankly. But what you get is this open vibrant system. The Internet has been so famous while metro is the tradition that we grow up in and that we're trying to see carry forward. And I am optimistic about it frankly.

Doug Anmuth - JPMorgan

And Reed, actually for David let me switch gears a little bit, but sticking with net neutrality. If the condition in the case arises where we don't have strong net neutrality going forward, how do investors get assurances that the business is protected, in terms of cost, perhaps interconnection costs over time? And really thinking about it both on a short-term basis, and then over the long term.

David Wells

On a short term basis I think there is great assurances in the sense that we've been able to sign these immediate interconnect deals and still able to achieve our margin targets. And when our guidance implies these costs are embedded. So I do think it's about a long term cost and we'll see where we go from here in terms of years. I think for Netflix content is our largest cost. It dwarfs all the other costs so it think it's really about profit margin at that point and in terms of how much margin goes to a delivery cost versus other cost in our business, we would rather spend it on content.

Michael Nathanson - MoffettNathanson

Reed just to be our last unless my after net neutrality, you referenced the Virgin relationship in the UK as being helpful. Can you give us any more specifics on the rates of growth you get when you become closer to the distributor or the MSO? So anything you could talk about maybe growth rates in UK pre and post the Virgin relationship.

Reed Hastings

Well, we're going to get live on Virgin for about six months. So what we can say is the initial reaction has been positive. It's not transformative to ballpark and I don't think for either of us. But it's great for consumers on input number one that's their default input to be able to use Netflix on the device, the Virgin set top that they use most of the time. So I would say it's an incremental positive. When you look, there is so many new smart TVs coming that have Netflix built in. There is going to be lots ways access Netflix, the Chromecast, Apple TV, Smart TV, NBPD Set Top. So, it's a nice positive but it's not transformative.

Doug Anmuth - JPMorgan

David, a question just around free cash flow. As you're ramping up originals here fairly aggressively, and you obviously mention a number of titles that are in production, and as that ramps up into 2015, can you just help us understand how we should think about the impact in terms of working capital around originals, and how we should think about that future trajectory of free cash flow versus EPS going forward? Thanks.

David Wells

Sure. It's no different than we've said before, which is the two main things that are pressuring cash use, our content expansion predominantly our produced content as well as our international expansion. So Doug I don't think anything has changed, I will say that we've been able to bubble on sort of at flat to slightly up in terms of free cash flow if we expand more aggressively internationally obviously that will pressure a little bit. And as we continue to expand original content and produced content, that will expand. So investors should expect to see a little bit of dip in Q4 and Q1, and it will be tied to that expansion of content. And in the future it really depends on how fast we expand internationally.

Michael Nathanson - MoffettNathanson

Ted, following on that answer how does the content offerings defer domestically and internationally, how is the local language factor play in due to source more locally than we probably would expecting France and Germany versus Canada and the UK, so any update on your strategies about sourcing content internationally.

Ted Sarandos

Michael, what's been really great is how much the content travels. So, in all of the international territories and France and Germany, appear to be that much different. It's somewhere between 10% and 20% local and mostly the rest of the international product, mostly Hollywood product that people want to see around world.

So we do have a heavy focus on accessing the local content that matters, and establishing local relationships with local producers. In every market we imagine when we get out to some more exotic parts of the world that that may skew a little more local but today it has been well within that 20% local range.

Doug Anmuth - JPMorgan

So a question on international expansion, perhaps for Reed. So if we think about the six markets that are coming here over the next few months, it feels like there are some specific nuances to some of them, perhaps Germany, which is more of a debit card than a credit card market for example, France, which has some protections around its own local content. Can you talk about some of those nuances, and how they are likely to impact your business?

Reed Hastings

Well I think Doug in every market around the world there are new answers. Just to give you an example in Brazil there is a tremendous payment complexity plus the leadership of TV Global. In Canada, there is the CRTC; in the UK the BBC is quite unique in its role in society. So think of us as adapting to the local conditions in each case. As you point out in Germany there is a number of aspects that are unique as well as in France and we're going to see this as we continue to expand beyond France and Germany and other countries that their unique conditions in every market. And our challenge and excitement around company is becoming a great global company where we really understand the new each of these markets and do a great job for consumers around the world. So there are some challenges there, there is no question I am sure we'll stop our toes on something and pick up the pieces. Like with payments in the beginning of Lat-Am three years ago.

We've had a lot of confidence about being able to figure out the issues once we get started. So that's why our view is we should get in the market we should get in the market, we should figure things out and then figure out those issues again around payments or other things in Germany and France.

David Wells

Following on the answer to France for Reed. There is a government policy in France called perceptions and you're familiar with it. Where you have to fund a certain number first local productions and also pay taxes to authority. So how did you get around that issue, where in France is very protectionist about the content that could be shown in?

Reed Hastings

We're not really trying to get around anything, we want to invest in French society and French contact. And we want to give an avenue for French content to get out around world. There is some amazing French story tellers as a great French movie business, TV shows are growing. We're looking to do some investments in France with production that we can do, we could joke about it the House of Cards House of their Side, that's not literally the kind of thing that would be. But something like that where it's a big French production but it's not just for France it's for the whole world. We're actively licensing again fresh content.

Thinking what we're trying to do is connecting the world as some of the world's best content brought to the world's Citizens. And that's really motivating for Ted for me for all the people at Netflix. And so we definitely got to work with French society and with the assumptions and beliefs that they have and we want to be loved in France by French consumers because we understand French content because we give it a bigger home and because we're bringing some variety, like U.S. television shows, things that historically have been under distributed. Ted do you want to add to that?

Ted Sarandos

Yes I would just say for all of that protectionism and all of the cultural favors that the Mentalist is the most popular television show in France. So the taste don't run that far off when you get down to the consumer. But I am really excited to have France look at us as somebody who brings opportunity to the market not there to harm the market in anyway. And that we will employ French production employees and create great content in France but as Reed said for around the world. And we currently even have Gaumont is a French company that produces Hemlock Grove 1 now and is about to go into production with Narcos. A lot of our animation projects are co-productions with French production companies. So this is not new ground for us. We're really excited about it.

Doug Anmuth - JPMorgan

Ted, just following up there, can you give us an update on certain content that you have as originals in the US and other parts of the world, but that you don't currently own on a first run basis in Germany and France? I believe such as House of Cards and your thoughts just on how material that is to the service?

Ted Sarandos

Well Doug because we're expanding our original so rapidly, I don't think it's necessarily detrimental, we love to have House of Cards in the first window France and Germany but it's been very successful for others there. But Orange is the new Black we'll be launching in for the first time in those territories and all of our going forward series will also be there. And we're back filling by having some other first run content like from From Dusk Till Dawn and other series that will premier in France and Germany for the first time on Netflix as well.

Michael Nathanson - MoffettNathanson

Ted do you have to change the way you source content? Would it be more efficient for the company to buy media going forward? So do you think about that and what's the impact to the business model by doing that?

Ted Sarandos

The more we expend the more that you reach those tipping points of the economics makes sense to buy out the rest of the world for different projects. When we first got in remember we were taking a pretty big bet on House of Cards right up the bet, so we're kind of hedging it a bit by leaving some of those other territories on the table and as we have gotten more and more international and more and more original, we are picking up those territories today.

Doug Anmuth - JPMorgan

David, a question just about the overall addressable market internationally, and I think you go into a little bit of detail in the letter, but you mentioned 700 million broadband households, I believe, globally. We know the 90 million or so in the US, and adding -- expanding international here to 180 million. How are you thinking basically about the rest of the TAM, and the ability for that to grow here over time?

David Wells

Those numbers 730 is Kagan's number there is another number that 800 that's Price Waterhouse's, so around that range of 700 million to 800 million are today is broadband households. In all of these territories, mainly outside the U.S. in most of the develop markets in Europe are growing at a much faster pace. So those numbers are going to grow and grow. For us if you look at China about a quarter of that 730, we're addressing a large swap in Europe and we would look to further that in Europe later if we're successful.

And so we like what we see as Reed said earlier we're really do see widespread adoption and join in Netflix as a product, beyond demand and aspects the great content that's produce in any market and the exiting aspects of us as a global distribution platform are being able to bring great content to markets in the U.S. to markets in Europe and Asia we like the prospects of our opportunities there.

Michael Nathanson - MoffettNathanson

David just mentioned China is a large source potential broadband household, how do you get into China, what you're thinking about potential timing of the China expansion.

Reed Hastings

Well, let David address that.

David Wells

I think it's early. It's fair to tennis match that right back at me, Michael, but I think it's pretty early, I think my reason that I would say it's the quarter is it's conspicuously large, and it's conspicuously a growing and very strong economy. So look for the future, in terms of an answer from us in China.

Doug Anmuth - JPMorgan

Great, just shifting gears into the US streaming business. As you approach 40 million streaming subs in the US toward the end of this year, and you're looking toward that lower end of 60 million to 90 million that you talk about, how do you think the mix of net adds changes between gross adds and churn going forward, and does lower churn really become an even stronger driver of the business?

David Wells

I think that obviously we do think that we've got growth in both so it would be growth in reducing term or improving our retention and in bringing more and more people into the market I mean all originals have the potential as we produce more and more contact to sort of bring more people into Netflix and new types of subscribers into Netflix.

So I think overtime Netflix will set more and more to people who are coming back and people who are staying longer just as we penetrate deeper into the U.S. but we still think we got some room to grow on both side.

Michael Nathanson - MoffettNathanson

Ted when you figure that your U.S. mix what you think the mix of expenses would be between originals, acquired, TV acquired film and what the right balance of spending across three buckets.

Ted Sarandos

Overtime Michael I love if you think about it most of that because we have a lot of programming like Breaking Bad that in the UK it's a Netflix's original show and in other territories it's a license. And we move pretty firmly in and out of that so big into our margin guidance is our content spend and we want to move a lot of it to originals most of because we have founded it's given us new brand strength as those shows have been successful and they continue to prove to be successful and let them move down that further.

But there is a lot of times where we will premiere the sequel to Breaking Bad, Better Call Saul; we're going to premiere that everywhere outside the North America Netflix. So that's kind of the reasonable ratio and kind of not for us in terms of how we treat it.

So really if you want to think about it is total content expense and we want to get the content to consumers love and right now we're having success in that area and we want to keep pushing down that path. So there is no optimal mix in that way.

Doug Anmuth - JPMorgan

Ted, can you walk us through what the release schedule looks like for originals just through the rest of 2014 and then into 2015? And I realize it's tough maybe to choose between your kids here, but what new shows are you particularly excited about?

Ted Sarandos

Well we've listed out all the premiere dates. The ones coming up in August, where we have BoJack Horseman, which is our first foray into adult animated comedy. It has Will Arnett and Aaron Paul voicing it, it's very funny, and it's again it's a new broadening of what we're doing on originals that's pretty exciting. And then we have the fourth season of the Killing also coming out in the couple of weeks and we're also really excited about in August.

The one that’s very ambitious on the large scale and we’ve been really thrilled with how it’s been coming in is Marco Polo that we’re filming in Malaysia right now. It’s a very large scale show we filmed in Venice, in Malaysia, in Kazakhstan like we’re trying to do things that would be very difficult to do on conventional television Marco Polo is a very ambitious project that’s coming together really beautifully we’re really excited about that for Q4.

Michael Nathanson - MoffettNathanson

I wonder from when you first started you basically built a service on library acquired content. You've evolved to exclusives and originals. I wonder when you look at usage trends today. How important are the library achieve shows that you have won the first round of negotiations with studios persons I thinks are buying out so to talk a bit about the heavy usage trends among your consumers as you’ve gotten longer to the process?

Ted Sarandos

The great thing about this time that we are in right now Michael is that content is still great and there is so much are being produced you can barely watch it all in our lifetime. So, the library becomes important because most people have never seen it, so it’s new to them. We are producing and bringing out original programming and about as fastest basis we can and maintain in the kind of quality that we have been able to. So, we are going to continue pushing on that path and originals is going to be a important component of that all the time but we will also I think we would always be a very valuable ultimate buyer for networks because so much of that content is never been seen by the public.

So we are excited that we will to continue to play in that space where pretty popular at May screenings, we commit when they are showing those projects for us to potentially be a first window partner for those shows outside of the U.S. and because we are not lead to we are only going to put on the shows that we produce that gives us the opportunity to put a lot of content part of consumers that they love regardless of the business model.

Doug Anmuth - JPMorgan

Ted, I just wanted to follow-up on a point that you said earlier, just around contracts. And I guess I'm curious how the initial kind of contracts around House of Cards and Orange may differ from what you're signing for new original series now, and is it fair to think that you are getting all of the international or global rights basically for these new originals that are coming out?

Ted Sarandos

The key for us that is we are trying to make sure we have we can control the exploitation in those territories particularly the ones that we are heading to. So, you can either get through that by owning the show outright or by negotiating to control of those rights with the content owners and have them as partners and I'm open to either one of those that give us those kind of controls to that when we open a new markets we can launch those titles with us, if they are coming up at a time that makes sense, given them that we put so much branding power behind those shows leading up to the launch.

Michael Nathanson - MoffettNathanson

Reed, can I ask you about international competition? You really enjoyed a first mover advantage in your first markets you went in to but now you see a lot of European markets where this two or three services outside UK, let's say in Germany and France, trying to do what you are doing, how do you think you would be able to differentiate yourself in the competition levels in terms of those markets where someone like a Sky, Sky Deutschland is already trying to achieve the same type of service?

David Wells

Well, it's a bit revisionist history, Michael because to say that we were first mover, because if you think about the UK, LOVEFiLM had been there for seven years, developed 2 million subscriber base, bought by Amazon infused with sustaining content was a tremendous significant competitor to us two and a half years ago when we launched. But what we did is we focused on television content, they focused on movies, we focused on incredible streaming performance that you never got buffering, working with all the integrators. And fundamentally it's a focus thing, which is, it's everything for us whereas this was a project for someone within a larger company and then now two and a half years later of course LOVEFiLM has folded up as a brand so we are tremendously excited about the opportunity to continue to move forward.

We have also had Sky from the beginning in the U.K. we are very aggressive competitors, lots of different aspects of their service. But what it's turned out is that we can grow very substantially in the U.K. and Sky is untouched similar to here in the U.S. how we are growing rapidly but MVPD as a total is untouched. So I think, the big MVPD is recognizing them you know Netflix is one more network just like YouTube it doesn't change our outcomes in any material way and we have again great focus, global R&D and those are the things that we look forward to. But in the end of the day there may well be room for several of these services in the market with different types of content that each have a exclusive content, if you think historically in the U.S. like HBO and Showtime, they are not really competing against each other except for content they are competing to get part of someone’s entertainment budget and in the same way we are like that in the new markets. So, we don’t need to beat some new competitors, we just need to create an incredible service that all of that all of the citizens in each country that we serve want to be part of Netflix.

Doug Anmuth - JPMorgan

Great. Ted, can you talk more about your plans for Chelsea Handler's new show coming up, and does this signal more of a move into live streaming, and now that you're moving more into late night talk, is there more of a strategy potentially around sports content over the long term?

Ted Sarandos

I think Chelsea is going to be a kind of great representative of the kind of concept the programming on Netflix because her show is a lot about the entertainment world, movies and television and culture and we think that it will be a great addition to Netflix in 2016. We just filmed her comedy special in Chicago and as you are going to do four more in 2015 and the show itself you should think about it is the way that people are not watching scripted programming the way they used to but also not watching these late night talk shows the way they used to. I mean they are not watching them at 11:30 they are watching in days, weeks sometimes in months later online or on stacked episodes on DVR. So what we are hoping to do with Chelsea and her team is to create a show that’s built closer to the way people are going to watch it, the way we have done with serialized dramas where we to took out the commercial breaks and the cliffhangers and really produce it the way people watch. And we have got a lot of time between now and then to work through all the format details and Chelsea is incredibly excited and we are really excited about her brand and we think it’s going to be great for us. And in terms of your other question, I think about it as more of a continuum that this is not that instantly perishable content by any stretch but it’s to your point it’s more perishable than a movie but the economics kind of level that out for us.

Michael Nathanson - MoffettNathanson

David and Reed, this question on international margins, do you think that international margins in their end state will look like U.S. margins or anything structurally different about your international businesses or the scale versus the U.S. activities?

David Wells

This is, David, I will take that one. No, there isn't. We have gotten this question before. There is nothing really different about our international businesses that we can't achieve U.S. like margins or better in some of our markets. It really is about the competition in those markets and in terms of what consumer alternatives are there and how much we are able to charge and the value that deliver to these consumers but there is nothing structurally challenging about those markets that we can't achieve equal or better.

Doug Anmuth - JPMorgan

David, just a question on the balance sheet. Can you help us understand how you think about the right amount of cash to have on the balance sheet, just given international expansion and then current free cash flow generation? And as part of that, we see the streaming content obligations move from $7.1 billion to $7.7 billion, which I think is one of the more significant moves that we've seen in recent quarters. And just how we should interpret that?

David Wells

The content obligations are a little bit lumpy, depending upon what we do on produced contents, so I would look at it sort of over a year-on-basis basis rather than a sequential basis. But you are right, they have gone up some, they will continue to go up as we expand and grow our produced content line and to some extent our international expenses as well as we signed up for multi-year deals, those obligations roll-on to the table as well. So, the right amount of cash, cash is not an inoculator in terms a prolonged competitive battle. It does help in terms of short-term that does help the business in terms of making producers and others feel good about our balance sheet position. I would say in general, I was a bit worried earlier on say two, three years ago when we're going through 2011 that we're little thin and I thought we will be burning at faster than we actually did.

So, for a while there I was a bit of little in terms of saying, telling investors, we are going to start burning, we are going to start burning and we really didn't. We grew it a little bit. We stayed flat for a while, so I think I am pretty solid on telling folks, look in Q4 and in Q1, we are going to start using cash a little bit more as we expand internationally and as we grow our content spend. And in the future, it will really depend on our international, on the pace of our international expansion, so I think I feel good about the level we are at now and it will really depend on our future plans.

Michael Nathanson - MoffettNathanson

Ted, just recently this week, I think you announced the pay one deal in Canada for Disney and I know you have done a couple of pay one deals elsewhere. Where do you think the potential is to really break the pay one window outside the U.S., so is that to know we can see more deals like that going forward?

Ted Sarandos

I made a distinction before around the Disney relative to the other studios in that, for us the Disney output deal represents a pretty big chunk of kids viewing in general, so I think of it more like a kids programming move that also has a lot of movie component, so it's a really great movie components with the Marvel Films and certainly the upcoming Star Wars movies. What's really interesting about the Canadian deal is that Disney is now going to move that deal in U.S. and Canada to one supplier which has not been the historic norm and we are also going to line up the window, so our Canadian subscribers can be seeing movies at the exact same time as U.S. subscribers. And we do have other pay one deals around the world including a Warner Brothers in the Nordic as an example and a few others.

But for us it's getting access to films, try to continue to narrow that window, so we can get them to consumers sooner and sooner. To kind of deliver on the expectation that the Internet has set-up for what I want, when I want, where I want.

Reed Hastings

Doug and Michael, why don't we do one question each for you guys and then we will wrap it up.

Doug Anmuth - JPMorgan

Okay, great. So I wanted to go back to something we touched on earlier, and I guess it's primarily for David. Just trying to understand better, and hope you can drill down more on the 30%, why that's the right level to go to and then reassess the domestic streaming margins, and help us understand better how you think about these tradeoffs that you mentioned in the letter, the 400, 200, and then 100 basis points of margin improvement on an annual basis?

David Wells

Doug, there is nothing magical about the 30% number. It's convenient level for us to reassess and we think we will get there next year, so there is nothing magical about that one 30% number. And then in terms of how we think about the next target whether we leave that at 400 basis point year-on-year growth or whether it goes to 200 or 100, it's really about do we think that we can continue to expand our market and solidify our competitive position with investments in content or do we think that we can continue to grow content at a moderate, slightly less aggressive pace and put more to margin. As we grow what we have explained in terms of that margin number getting bigger and bigger, it just gets harder to deliver 400 basis points of growth on a higher and higher margin, it's just the math behind it. So it may not be the right thing to do to continue to press forward as aggressively on content or on profit growth versus other things that we could spend money with content being the largest one.

Michael Nathanson - MoffettNathanson

I would say following on that is for anything that you know today on the content cost side like the Disney deal that coming June 17 that makes you say that, do you, have you looked at your -- is there something you're looking forward and say hey, that is a hurdle that could change it?

Reed Hastings

No, Michael, this is more about perspective opportunities spend on the content line. We forward plan our business, we foreword plan our content spending fully, knowing fully well that that Disney deal has been done over a year then we have projections, Disney could have 20 releases at $400 million plus box office, but that's not likely to happen. So I think what we've done is taken a bunch of different median scenarios and say, look we've got that planned out. It's really about what else can we do with it, can we do more experiments in Ted's world in the produced content? Can we license for content is that the right decision versus profit growth and making a very smart decision as business owner long-term about the competitiveness and setting ourselves up competitively through the long-term.

David Wells

Thank you everyone for joining us for the call and that we look forward in October to be able to report to you on our initial success with our French and German launches. Thanks you very much.