

Good afternoon, and welcome to the Netflix Q3 2019 Earnings Interview. I'm Spencer Wang, VP of IR and Corporate Development. Joining me today are CEO, Reed Hastings; CFO, Spence Neumann; Chief Content Officer, Ted Sarandos; and Chief Product Officer, Greg Peters. Our interviewer this quarter is Mike Morris from Guggenheim. As a reminder, we'll be making forward-looking statements, and actual results may vary.

With that, let me turn it over to Mike for his first question.

## **Question-and-Answer Session**

### **Operator**

#### **Mike Morris**

Thank you, Spencer. Good afternoon. Let's start by talking about both member trends and the outlook that you just provided for members in the fourth quarter. Starting with the third quarter, can you speak a bit about some of the key drivers that - your results came in relatively in line with your guidance. Talk about the gross add dynamic and the churn dynamic there relative to what you are expecting coming into the quarter, please.

#### **Reed Hastings**

Relatively in line. It was the most accurate member forecast we had in years. Spencer, over to you.

#### **Spencer Neumann**

Spencer or Spence. I'll take it. We got a lot of Spencers on the call. I'd first say, Michael, it was a really strong quarter. I mean not just around subscribers but around overall business performance that was record revenues for Q3, record operating profit and nearly \$1 billion of operating profit and record paid net adds for the quarter. We delivered on the subscriber front slightly ahead of where we expected outside of the U.S. In the U.S., we were a little bit short.

To your question, what drove that, we're talking very small numbers here, but we did see some elevated churn in the quarter that -- we had seen some elevated churn following our price increases in the U.S., and that ticked up and sustained through the quarter longer than it had in the past.

But these are really small changes, we're talking about like 0.1 of a percentage point in churn. And that's why, at the same time, these price increases are hugely revenue positive for us, as you saw in the quarter, and so we take the bulk of that revenue and reinvest it back into the service,

into great content, into great product experience for our members to continue to deliver on that value proposition and continue to grow our business.

### **Mike Morris**

Okay. I want to come back to the topic of churn. But before we do, I just want to ask about the fourth quarter outlook. On the last call, we spoke about potentially seeing a record year of net subscriber or net member additions in 2019. The guide does not imply that at this point.

So can you talk a bit about perhaps what changed? And I think the big question in investors' minds is will 2018 represent a peak year for member adds or can you get back to growing on top of that level again.

### **Spencer Neumann**

Sure. I'll take that one again, too. So in terms of our guide for the year, yes, it is down a bit from our previous forecast. And really, what we're just trying to do there is to be prudent about the - there's a number of moving parts in Q4 and variables that are just difficult to forecast.

And whether it's, first, just the ability to be precise about a forecast around our content slate that has so much new IP in Q4 and big film - a big film IP that we - we've never had a quarter with so many big films launching in a quarter. Combine that with some of that elevated churn that we saw in Q3 and the potential for that to continue into Q4.

And then lastly, there is obviously a few new competitors launching in the near term, and we try to factor that in as well. Inevitably, there is probably going to be some curiosity and some trial of those competitive service offerings. So when we put all that together, again, we adjusted our forecast slightly. It's still nearly 27 million paid net adds for the year, a tremendously strong year.

And furthermore, it is - our long-term outlook is unchanged in terms of the long-term opportunity for the business. We're just trying to be prudent about our Q4 forecast.

### **Reed Hastings**

Mike, in the prior year, in the U.S., we did 5 million net adds. And this year, if we're on forecast, it will be about 2.6 million. So the gap's almost entirely in the U.S. That's really on the back of the price increase. There is a little more sensitivity. We're starting to see the - a little touch of that. What we have to do is just really focus on the service quality, make us must-have. I

mean we're incredibly low priced compared to cable. We're winning more and more viewings. And we think we have a lot of room there.

But this year, that's what's hit us. And we'll just stay focused on just providing amazing value to our members in the U.S. And I think that gives us a real shot at continuing to grow net -- long-term net adds on an annual basis. But we're going to be a little cautious on that guidance and feel our way through here.

### **Mike Morris**

Yes. And on that elevated churn, just to kind of wrap on this, what type of subscribers are you seeing churn more often? Does it tend to be really that hit driven nature around a particular programming? Does it happen to be sort of the last subscriber in is less sticky? What are you seeing there?

### **Reed Hastings**

Mike, at 0.1%, it's 1 in 1,000 people, so you really can't tell the margin. Think of it much more big picture, which is it's always a question of how much value do we have, how do the consumers feel it. In moving up ASP in the U.S. from about \$12 to about \$13, we see a little bit of it. And then what we have to do is just give it a pause and really focus on the value.

If you think about it, we haven't had many big movies in the past, and movies are very valuable, people are used to paying for a lot of that. And the slate that Ted and his team have this quarter and for next year is way better than any movie slate we've ever had. There's some great room for optimism there, too. So we just have to focus on the members, and I think it will shake out very well.

### **Mike Morris**

Okay. Thank you. And so let's talk about competition. Spence brought the topic up, so I'm not introducing it. I know it's been a hot topic. But Reed, you spoke in the U.K. a couple of weeks ago. You made a comment saying it would be a whole new world starting in November. I think a lot of people - a lot of investors just read the quote, they didn't necessarily see the interview for context.

And so I'd love it if you could provide some context given that, that is a bit different from your comments from a couple of quarters ago where you felt that perhaps these new services wouldn't necessarily be material to the outlook.

### **Reed Hastings**

From when we began in streaming, Hulu and YouTube and Amazon Prime back in 2007, 2008, we're all in the market. All 4 of us have been competing heavily, including with linear TV for the last 12 years. So fundamentally, there's not a big change here. It is interesting that we see both Apple and Disney launching basically in the same week after 12 years of not being in the market. And I was being a little playful with a whole new world in the sense of the drama of it coming. But fundamentally, it's more of the same, and Disney is going to be a great competitor. Apple is just beginning, but they'll probably have some great shows, too.

But again, all of us are competing with linear TV. We're all relatively small to linear TV. So just like in the letter we put about the multiple cable networks over the last 30 years not really competing with each other fundamentally but competing with broadcast, I think it's the same kind of dynamic here.

### **Theodore Sarandos**

I think I got the subtlety of the brave - the whole new world Aladdin reference. Everyone else took it pretty literal.

### **Reed Hastings**

And Ted, why don't you talk a little about the movie slate and how it's different? If there's a whole new world, it's really about our movie slate more than anything else.

### **Theodore Sarandos**

100%. I think we've got - just in the fourth quarter alone, we're talking about films that are - that range from a massive scale action film from Michael Bay with 6 Underground to Oscar hopefuls like The Irishman, Marriage Story and The Two Popes, Eddie Murphy's return in Dolemite.

So these are big, theatrically ambitious-type films that you'll be able to watch on Netflix, included in your subscription. It really is a fundamental change in the economics of how people enjoy films. So we're really excited about it. And it's our first time we've seen the scale and this volume of films in one quarter, so we're really excited about it.

### **Mike Morris**

Before we dig into some content questions a bit more, do you want to talk about pricing a little bit and the pricing power in the U.S. market? So perhaps for Greg or for Spence, two things.

Number one, do you think that the lower price point for some of these new services will negatively impact your ability to raise your price in the future? And maybe more broadly, can you talk about equilibrium price for this service? We would love for you to give us a price point. I know that's unlikely. But as you just think about -- you could be a great value with a number of different price points, but how do you think about where that sort of shakes out?

### **Gregory Peters**

I think the pricing of our competitors we don't feel as a real significant factor in determining where -- what we can change for our service. Again, the services and the content are highly differentiated, so one is not something you're going to choose to do just for us.

But I would say our job and then what we think our pricing for a long-term perspective is continue to take the revenue that we have that our subscribers give us every month, judiciously and smartly invest it into increasing variety and diversity of content where we really want to be best-in-class across every single genre.

And if we do that and we're successful in making those investments smartly, we'll be able to continue to deliver more value to our members. And that really will enable us to, from time to time, ask for more revenues so that we can continue that virtuous cycle going.

### **Mike Morris**

And so I don't know if you can speak any more about it, but is there a place where whether it's relative to a pay-TV subscription in a certain market or relative to other streaming services that you think set some sort of bound around where pricing could ultimately go to?

### **Gregory Peters**

I think you can look at a couple of external ones in terms of pay-TV packages that might be relevant, but we don't really look at it that way. We're looking at it more sort of incrementally and let our subscribers sort of tell us, as we add more value along, where that right price should be. It's a - we're really more focused on listening to subscribers and sort of walking that path with them.

### **Mike Morris**

Okay. And one other question on pricing for you, Greg. A couple of different dynamics especially outside the U.S. where you have different price points. You tested a mobile-only plan, a lower price plan in India.

Could you talk a little bit about perhaps the variety of tests and pricing points that you have in the marketplace right now and any differentiation you can give us between more mature markets that -- with some stable pricing test, anything like that so we can get a view going forward?

### **Gregory Peters**

Sure. Just to talk a little bit about where we are in India, I mean again, we think about revenue as a guiding principle for us. We do these different tests and try to figure out what is the right set of plans that have the right benefits, the right features that are delivered at the right price for the subscribers in any given market.

And I think what we're exploring is, as we are operating in markets that have very, very different conditions, very different levels of affluence and other forms of entertainment competition, et cetera, what is the right structure for us.

And so we've been very, very happy with the mobile plan. It's actually performing better than we tested. We'll look at testing that in other markets, too, because we think there are other markets which have similar conditions that make it likely that, that's going to be successful for us there as well.

But I also think we're going to look at other plan structures, other feature value benefits where we might see different market conditions that will work there. And I won't get into sort of leaning into those, we'll see them as we roll out, and we'll respond to them based on what our consumers in those markets, our members to be in those markets are telling us is working or not.

### **Mike Morris**

Okay. I want to come back to competition but this time talk about competition for content. Ted, you teed up a bit some of the things you're enthusiastic about going forward. Reed, you did make the comment again in the U.K. that someday The Crown would look like a bargain. Perhaps another sound-bite that was picked up but perhaps you can provide some context around that.

Maybe generally, how do you think about the investment that you want to make in programming from a very high level? Is it an overall budget? Is it a cost per subscriber to a certain level? How do you think about that?

## **Theodore Sarandos**

I would say the exciting thing about this moment in entertainment history is that the scope and scale and ambition of television is beginning to rival that of feature film, which is an incredible win for consumers. And so when Reed was talking about The Crown, he was talking about relative to the joy and the hours of watching,

The Crown will just look like a bargain and that -- these things on big scope and scale. And our -- we're pretty uniquely positioned with a \$15 billion content budget to be able to deliver on those scope and scale at the same time for film and television.

So that incredible - that slate that I just rattled off to you, it's happening at the same time that we have returning seasons of End of the expletiveing [ph] World, The Crown, Lost in Space, You, all incredibly popular shows. Casa de las Flores from Mexico, Baby from Italy, all back for returning seasons.

Breaking brand-new series like The Witcher, Daybreak, all at the same time being able to deliver on what we think is an incredible value proposition for the viewers. So you were asking earlier about price, it's really price relative to value. And if you're spending more and more time watching TV shows and films on Netflix, you are realizing an incredible value. And I think that's really how the consumer experiences it.

## **Reed Hastings**

Ted, as much as you can ballpark it, a show 5 years ago producing that same show today, sort of 50% more expensive, 30%?

## **Theodore Sarandos**

It's a really hard one because the range is huge, and sometimes the big breakthrough is not the one that turned out to be that came into it that competitively. But on a very competitive show, there's probably been 30% price escalation from this time last year.

## **Reed Hastings**

In 1 year.

## **Theodore Sarandos**

In 1 year.

## **Reed Hastings**

No, that's a lot. But definitely, content pricing is rising. But when -- we are fortunate to have the largest membership, one of the biggest revenues and the biggest content budgets, and so that's what's in there. We're able to still be very competitive sort of in shows.

### **Theodore Sarandos**

And as you pointed out, it's an elite few shows that are that competitive that would see that kind of escalation. Just in any environment where you've injected a few new buyers, you're going to catch that dynamic on a highly competitive show.

### **Spencer Neumann**

The only thing I'd add also, just to reinforce, we look at a lot of things. We don't chase everything, and we also lose on opportunities, right? So we're exercising discipline every - all the way with every single title, we're assessing every title individually. And where -- one is, as Ted said, with the size of content budget, we'll take big swings and we can make some mistakes because we don't have any kind of single title content concentration.

But we are, because of that discipline, we're continuing to march towards increasing profit margins, improving our cash flow trajectory over time. So this is with discipline and business discipline while we are going after these big swings.

### **Spencer Wang**

And Mike, at the risk of hitting too hard the diversification point, just sort of mathematically, investors can do the math on what \$100 million sort of project relative to a \$15 billion cash content budget or \$10 billion P&L budget means. It's incredibly diverse, right, so we don't have any sort of concentration risk. So I'd point that out.

### **Theodore Sarandos**

Yes. Considering our math, Spencer, but the idea that the rumored \$100 million that House of Cards invest going into the way, that would seem earth-shattering less than 7 years ago. Today, it represents about 1% of our content budget.

### **Reed Hastings**

And today, that would be a bargain.

### **Mike Morris**



So if I look at this dynamic then, continue to increase the investment in content, at the same time, growing your subscribers. Where are we in terms of achieving scale on that investment if we look at that content spend per subscriber?

Do you expect the competition to continue to drive that up? Or are we getting to a point of equilibrium where you're starting to see the benefit of that global penetration that you have?

### **Theodore Sarandos**

I wouldn't try to take a stab at predicting whether we're at equilibrium when there's so much fluidity in the market today. But I think what you're seeing now, there's an absolute cap, of course, so -- but anyone can pay for any given project, and it will get super competitive for a lot of them. So I'd say that we're investing forward and trying to win those moments of joy for our members, and that's what's driving us.

### **Reed Hastings**

And Mike, there's about 2 billion active users of Facebook, 2 billion active users of YouTube. We're obviously a fraction of that. And those numbers are continuing to grow. There are 6 billion active mobile phones in the world, and that's got to equilibrium. So equilibrium is so far away from where we are today. It's not something that we think a lot about, we think about how do we grow.

### **Theodore Sarandos**

Yes. Definitely in terms of member growth. I thought you were talking about content spend.

### **Mike Morris**

Sure. So let's talk about creating franchises. I have a question about that. I think there is a lot of enthusiasm, as you know, for the Disney+ product coming out. And I think it rides a little bit on the success of the streaming marketplace but also this concept that they have this tremendous content library and IP library that they've built over many years.

So Reed and Ted, as you think about that, I know you've made an investment in children's content over the course of the last quarter. Talk a little bit about franchises, the importance of franchises and whether building franchises is something that is your ambition.

### **Theodore Sarandos**

I think established IP has a leg up with consumers. They know what they're getting into. There's a prebuilt-in excitement. It makes the marketing a little easier. But in general, don't forget the power of brand creation. And what is the value of a franchise? It's really the value of brand creation and can you scale off of it. In this past quarter, we made a movie called Tall Girl, a hugely unknown cast, who, in 7 days, grew their social media following into the millions on Netflix and had over 40 million people watch it.

That's the ability to create a brand almost out of thin air, which, I think, is every bit as valuable as drafting off a bunch of other franchises waiting for them to burn out. That being said, we're very excited about the opportunity to do it ourselves. We see the value of franchises like Stranger Things and Black Mirror.

And so we're continuing to work to do that as well. But I -- think about it as not like franchises are better than non-franchises. Great stories are what matter, and the way that they reach consumers really makes a difference.

### **Mike Morris**

You had a couple of original programs, original pieces of content in markets outside the U.S., global pieces but focused in markets, Sacred Games in India, Casa De Papel in Spain, I'm thinking about it in particular. We saw Google search activity, let's say, multiples or at least doubling what their prior levels were.

So I'm curious, your thought about how that piece of content does drive that enthusiasm on local market. I think what that ties to really is, I think, the way we try to think about what the growth opportunity is. So I'd love to hear why you think you get that big step-up. And maybe in terms of Ted and Greg together, how you work together to try to make that happen.

### **Theodore Sarandos**

Sure. You saw in the letter our investment in local language original series and film is continuing to grow at more than 100 seasons of new local language original shows, and they make a huge impact in the market. Casa de las Flores, which will be back for a second season in Mexico, has been a tremendous success.

What's been great, too, is a lot of these titles that are hugely impactful in the country where they're produced also tend to travel throughout the region, sometimes around the world. Not -- so the Casa De Papel, the success of that show, was basically in almost every non-English-speaking territory. It was a phenomenal success.

We're going to see that coming up with a new show called The Wave from Germany where the stories can be very pan-regional. But the way that they travel and the way they make a big splash around the world is to be super authentically local and really satisfying for the viewers, starting in the home country and then expanding around the world.

And we've been -- we're on our fourth year of producing local language originals at scale, and we're excited about continuing to expand it. And they can -- the nice part is, is I think people will enjoy a global film or a global series every so often, love to see themselves on-screen, and that we're able to deliver on both of those propositions for our members around the world.

### **Gregory Peters**

Just to add to that, I think it's super fun and exciting to be able to take one of these really authentic local stories and connect it effectively with a broad regional or global audience. In many cases, we feel like we'd have never actually watched a show in that language or from that country before.

And the key to doing that, first of all, is obviously being available in all those countries in an easy-to-access way, but then it's connecting that show, having it be localized, in language with subtitles or dubbing, whatever is appropriate for that market, and then also explaining to users, to members why they're going to want to watch this amazing heist series from Spain and why that's going to be a totally compelling watch for them based on the other kind of content that they're enjoying.

### **Mike Morris**

And I think it's important to understand how broad your production is outside the U.S. So can you share any statistics on how many countries you're actually producing first-party production of content and what that sort of investment looks like in terms of building a moat there? And in addition, you just strike a partnership with Mediaset during the quarter, one specific partnership you could perhaps detail and how that can benefit you.

### **Theodore Sarandos**

Well, we've entered into most of those markets with joint -- in joint venture or in coproduction arrangements at the beginning and then take over many productions in those countries as we get scale in those countries. And we also continue to have great coproduction relationships with folks like Mediaset, even though our own studio is producing local Italian content as well.

So it's -- I'd say we've released original local language content in 17 countries to date, we're going to grow it to 30, and that's just going to keep growing around the world.

### **Mike Morris**

One other content question, you did make a high-profile commitment to rights for Seinfeld, which is a little bit -- I don't want to say counter but certainly different from the focus of allocating resources incrementally to originals. Can you talk about how big of a commitment is that for you maybe at least on a relative basis? And why is that the right decision?

### **Theodore Sarandos**

Well, we've seen - in the past, we've had a lot of questions about the value of volumes of catalog programming, meaning just having hours and hours of content that people don't watch. But we have seen there's a few titles in the history of television, Seinfeld being one of them, that continue to be incredibly relevant 30 years after it came out on television and get watched every night. It's kind of a comfort view comedy that travels around the world.

And Seinfeld is one of these very elite shows that came available in that time frame. So we have Friends till the end of the year, then we'll have Office for another year after that, and then Seinfeld will roll out to the world in 2021 on Netflix.

And we're incredibly enthusiastic about those shows. But they're very, very unique in the vast catalog of television ever created that people are still watching 30 years after it was produced.

### **Mike Morris**

I want to ask you some questions about windowing and sort of creating community among your viewers. One of the questions that we get is really about dropping an entire season at once versus having it spread out over a week at a time. You've addressed this question before, but I'd like to hear your more -- your current thoughts.

And I think the question is really beyond just why not do it every week but why do it, let's say, all an entire season at once, maybe you could split a season into pieces or the timing of a series. For example, we were asked why Stranger Things couldn't have been before the end of the second quarter instead of just after the start of the third quarter.

### **Theodore Sarandos**

So I'll give you a quick just personal anecdote. I'm a big fan of Succession on HBO, and I watch it every Sunday night when it comes out just like everyone else. And if I like that show a little bit less, I would probably burn out on it because I get aggravated every week waiting for the next episode. That's how much I like it. So you're trying to finely -- fine-tune the proposition to the customer, great storytelling, how and when they want to watch it.

And what we have seen in comparison -- because we have about 35 shows around the world that we release week-over-week because it's premiering in that territory of Netflix, and we don't want to -- and we want to deliver on it as soon as it -- as close to the broadcast window as we can.

So what we - and what we've seen is, in markets where we released it all at once versus 1 a week that we actually get more viewing and cumulatively more social media buzz, more tweets, more activity on social media around these shows for the all-at-once model. So people are coming to it at different times. They're loving it more. It's in a more concentrated experience, for sure.

All of that being said, we are doing things like producing -- like you saw with The Ranch where we are producing 10-episode seasons with smaller gaps between seasons, so coming out 6 months apart rather than a year apart.

You're seeing we're testing an interesting release pattern with Rhythm + Flow, a music competition show, that - and basically, what we're trying to do is match not just the program exactly that you want to watch but how do you want to watch it. And for a lot of people, it may not be all at once, but it's hardly ever 1 a week.

### **Mike Morris**

Right. Do you see more opportunities for that? Whether it's unscripted or the type of program, it's not live per se but it does lend itself to a little more pent-up excitement, do you see more opportunities to put resources behind that or is it opportunistic?

### **Theodore Sarandos**

It's opportunistic. We're trying a lot of different things. We're trying - basically, what we're trying to do is make your favorite show, whatever that is. And for some people, it's going to be a music competition show. For other people, it will be Green Eggs and Ham.

So we really are trying to make your favorite show, whatever it is, and be best-in-class at all of those things. And there might be something unique

about the release rhythms of competition shows and more topical talk shows that lend themselves better to frequency release.

### **Mike Morris**

You spoke two quarters ago, you updated it a little bit last quarter, the topic of providing some more data or information both for producers, talent as well as for individuals.

My first question is, can we have an update on where we are in that, what you have provided and especially from a consumer perspective as well? I think the goal was to help create some more of that buzz, create more conversations, how is that playing out at this point?

### **Theodore Sarandos**

One of the things you saw, we've launched in the U.K. and we're looking to expand presentation of the top 10, so that people can come to Netflix and see the top 10 most popular things in different categories. Once again, I think that one way that people choose content is by popularity. It's not the only way, and it's not the only way we want people to. But if they want to use that as a tool to guide their decision-making, we want to help them do that.

So publishing that top 10 that refreshes every 24 hours is one way that we're helping out on the consumer side. Our producers, we share viewing data with every week on the lead of the launch week and the end of the month. So they are - we're incredibly transparent with our producers around the world, and we're going to be increasingly doing things like we did in our earnings letter and give you viewer stats on a lot of our projects as we go. Greg, would you add anything about the top 10?

### **Gregory Peters**

No, I think it's - you covered it well. And just to make it clear, I mean that top 10, that's a list that's available in the product. So to Ted's point, those members who really think that popularity is an important signal for them on what to watch, we'll have that available to them.

### **Mike Morris**

Great. Greg, I'd like to ask you a couple of questions on the technology, the product side. First, maybe an update on partnerships. We talked about it a bit on the last call. I'd love to expand, in the U.S., the pay-TV partnerships seem to be a big part of the focus.

Can you talk about whether that's become a bigger part of the subscriber acquisition product? Is it steady state? Help us understand where we are in that process.

### **Gregory Peters**

Yes. It's important, I think, to ground it in the partner-based acquisition component when you think about all the devices that we operate on and just being able to find and sign up new license, that's a healthy chunk of our acquisition. But then when you get to the bundles, which I think often people think about partners equals bundles, that's relatively small, but it's a nice incremental acquisition channel for us.

And so we'll seek to grow that. We think there's a bunch of opportunities both in the United States with existing partners and expanding the number of bundles and sort of the bundle availability. We'll also seek to expand that globally because we think there's a tremendous number of opportunities globally to add those kind of partners and make it easier for members to sign up.

We did a couple this quarter, whether it's Canal+ and Sky Italia with sort of new partners for our bundles, but we've also done things like take KDDI, a mobile operator in Japan, and be able just to expand our presence across their offering, which makes again an easier place more attractive for more members to sign up.

So it's still small, a relatively small fraction of our acquisition, but it's a nice, good, incremental way to access a member base, member to be based. It's less technology for less early adopter, and we can just make it super simple for them to sign up.

### **Mike Morris**

Okay. Another topic that we haven't talked about in a little while is that of password sharing or stealing or whatever you want to call it. As we get to a more mature growth trajectory in the U.S., does that come back into being something that's important for you to address? And how do you address it without alienating a certain portion of your user base? How do you strike a balance there?

### **Gregory Peters**

I think we continue to monitor it, so we're looking at the situation. We'll see, again, those consumer-friendly ways to push on the edges of that. But I think we've got no big plans to announce at this point in time in terms of doing something differently there.

## **Mike Morris**

Okay. And so Spence, I'd like to ask a couple of questions on the financial side, the first around the margins and contribution margin. In the past, you've spoken to a 40% domestic contribution margin target. Is that something that you still view as achievable?

And maybe within that context when we talk about competition, do we need to spend more, say, on the marketing side than you previously anticipated as you achieve what you want to achieve on the subscriber side?

## **Spencer Neumann**

Well, first, on margins, I guess -- so the good news is we did deliver over 40% contribution margin in the U.S. this quarter. It happens to be at the last quarter that we're looking at the business in that way as we talked about it in terms of changing the way we'll be reporting going forward. And we noted in the letter that we'll start reporting our revenues and our subscribers on a regional basis and then global operating margin.

That's really because, as we move to a world where we're both licensing and producing more and more original programming on a global basis, segment margin is not really the way we think about the business. Increasingly, we think about managing to a global margin.

We are breaking out that regional reporting on the revenue subscriber level because at that level, we are directly driving our business at a regional level. As we talked about this quarter, 90% of our growth is outside the U.S. And so we think about it in more than just U.S. versus international.

Frankly, we -- in terms of our continuing to grow our margins, again, we look at it on a global basis. We're driving, we think, scale and efficiencies and margin growth across the board.

Our content investment, while it's growing, it's growing slower than our revenue growth. And marketing, we'll market as we think appropriate and needed to grow our business. We have a very large increase in our marketing spend last year.

So this year, you're seeing spend at similar levels to last year, and that's because we learned a lot. We learned a lot along the way. We'll continue to test and learn. So we find new and different ways to reach our members every day.

And so we'll continue to turn the knobs there, but we're very conscious about continuing to drive up our operating margins on that global basis, the



300 basis point increase this year to 13%, and we talked about in the letter committing to 16% next year. So we'll continue to do that by driving efficiencies in the business while doing the requisite marketing to reach our members.

**Mike Morris**

And maybe we'll piggyback off some of those fundamental trends you just mentioned and talk about free cash flow as well. A little bit of a different dynamic with the investment on the cash side, but you talk about progress toward turning free cash flow positive.

Can you give us insight on some of the levers there, how to think about -- and you referenced the coming year, so maybe just highlight that for us and then really a progression of to 2020 levels, what is your expectation.

**Spencer Neumann**

Yes, sure. Again, we're committed to, starting in 2020, improve our negative free cash flow profile. We talked about this year that we're expecting roughly negative \$3.5 billion of negative free cash flow. Again, that is investment in future content to be delivered on our service. So we are profitable. We're increasingly profitable.

So that's why we see in 2020, as we continue to grow our profit margins, continue to scale our business at what you've seen this year, which is nearly 30% revenue growth and then increasing margins, that ultimately translates into more cash flow that can be converted into content investment and improving that profile. So -- and we've also been transitioning from licensed second-run content into original programming, so that created some of that working capital pressure.

But now the bulk of our content investment is original programming, so we've made it a long way up that curve. So the combination of our scale and our business model transition is well along, and that's why you're going to start to see that free cash flow improvement next year.

And then beyond that, we're not going to give specific projections. We'll continue to scale gradually towards self-funding while we continue to go after our strategic priorities.

**Spencer Wang**

Mike, we have time for one or two last questions, please.

**Mike Morris**

Sure. Well, I'll take the opportunity to finish with a question for each of you, so maybe get a little bit of a 5 answer bonus here. But I'm curious what each of you, if you wouldn't mind sharing, are most looking forward to as we get through the next quarter and you come to your next earnings interview, what's the one thing that you're most excited about being able to talk about as we look out there.

Maybe I'll start with you, Spencer, and we'll - for convenience, we'll work backward alphabetically by last name, so you guys can figure that out. Spencer, go ahead.

### **Spencer Wang**

Great. I guess for me, maybe fewer questions from investors on competition, but I think that's pretty unlikely. So I'll say, what I'm, I guess, really excited about in the coming quarter is actually 6 Underground, a new original film from Ted's team. I'm a big action film junkie, so super excited about that.

### **Spencer Neumann**

I guess I come next. So I'm super excited about The Irishman actually, can't wait to see that film. And also, frankly, it will be nice to have some of these competitive launches in the rearview mirror so that we can continue to look forward and all the things that we're excited about in terms of this huge global opportunity.

### **Mike Morris**

Great. I'll go to Ted next.

### **Theodore Sarandos**

Look, what I'm most excited about, we've got to be able to -- we have to do exactly what we're doing right now, which is we have to continue to make your favorite show, and we need to continue to deliver it to you seamlessly. And none of that changes in the upcoming.

And I think when I look at the quarter ahead, these guys already mentioned Irishman and 6 Underground, but I also think there are some incredible things between there with things like Marriage Story, like The Two Popes from Fernando Meirelles and Laundromat from Steven Soderbergh.

These are the most iconic directors of our time making their next film at Netflix. We have a building full of animators who have made the best animation for over the last decade making their next projects at Netflix. And

I'm really excited to be able to come in and update you on those 2 over the next quarters.

### **Gregory Peters**

And I'm pretty consistent with that. I think the opportunity to be able to expose our members to the kind of films that we are producing right now that are being released on Netflix in such a compelling way is going to be super exciting, and it's super fun to sort of look back on that and see how that goes.

### **Reed Hastings**

I look forward to blowing away the numbers. Accuracy is good when we have it, only accuracy [without] accuracy. But it's super fun to blow away the numbers. So fingers crossed, we'll see every quarter. It's a - the forecast is a 50-50 guess, as you see for this year, and we'll see what comes.