

Q2 2018 Earnings Call

Company Participants

- David B. Wells, Chief Financial Officer
- Gregory K. Peters, Chief Product Officer
- Spencer Wang, Vice President, Finance/Investor Relations & Corporate Development
- Theodore A. Sarandos, Chief Content Officer
- Wilmot Reed Hastings, Founder, Chairman, President & Chief Executive Officer

Other Participants

- Todd Michael Juenger, Analyst

MANAGEMENT DISCUSSION SECTION

Spencer Wang {BIO 3251222 <GO>}

Good afternoon and welcome to the Netflix Q2 2018 Earnings Interview. I'm Spencer Wang, VP of IR and Corporate Development. Joining me today are CEO, Reed Hastings; CFO, David Wells; Chief Content Officer, Ted Sarandos; and Chief Product Officer, Greg Peters. Our interviewer this quarter is Todd Juenger from Bernstein. As a reminder, we will be making forward looking statements and actual results may vary.

With that, over to you, Todd, for your first question.

Q&A

Q - Todd Michael Juenger {BIO 17171389 <GO>}

All right. Thanks, Spencer. So let's start with the obvious. So for the first time in, I think, five quarters, net additions came in below your own forecast both in the U.S. and internationally. So whoever wants to maybe could help us walk through where was the source of that shortfall and what you attribute it to.

A - Wilmot Reed Hastings

David, do you want to hit that?

A - David B. Wells {BIO 17034721 <GO>}

Yeah, sure, Todd. So in general, I would say acquisition which is up year-on-year but wasn't up as much as we thought it was going to be. And it was pretty broad across multiple markets. It wasn't any one area of the world. And as you pointed out, after four

consecutive quarters of under-forecasting the business; we over-forecasted the business. And we strive for accuracy. We clearly didn't pad the number.

But we think, based on the rolling 12 months of growth that we've had compared to the prior rolling 12 months of growth - the U.S. up slightly, internationally up significantly - that the background and underlying characteristics of the business haven't changed. Our total addressable market is intact and hasn't really changed based on those 90 days of actuals. And in general, we think that that conversion and growth to Internet-enabled entertainment is intact and people are loving it. People are adopting Netflix around the world, increasingly more in our newer markets as well. And so I think we're still on track for a strong growth year this year. And maybe it's going to come in a little bit differently than we expected and others expected.

A - Wilmot Reed Hastings

And, Todd, you noticed probably that paid net adds are up compared to year ago and forecast to be up a year-on-year over basis in Q3. And the fundamentals have never been stronger. Our viewing is setting year-over-year records, the shows that we have coming. So we're feeling very strong about the business.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Terrific. Let's stay on this for just a couple of more follow-ups and then we'll move on to broader things. Just wondered over the course of the winter, there were some well-publicized essentially global pricing increases. I wonder if you think that had any impact on either retention or gross adds relative to your forecast.

A - David B. Wells {BIO 17034721 <GO>}

We don't think so, Todd. If anything, all of 2017 we sort of had rolling increases in various different parts of the world. We were able to grow continually through that and we continue to do so. I don't think that is contributing to this trend.

A - Wilmot Reed Hastings

And, Todd, we've seen this movie of Q2 shortfall before, about two years ago in 2016. And we never did find the explanation of that other than there's some lumpiness in the business and continued to perform after that.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Great. Let me hit on Q3 really fast or else I wouldn't be doing my job. So you are kind enough always to give us a forecast for that. And it just stood out to me that I think it's slightly below the net adds from year ago. I only had a quick chance. So I think that's - I don't know if that's from paid or total or both.

A - David B. Wells {BIO 17034721 <GO>}

It's on total, Todd. So, as Reed pointed out, paid net adds are actually up year-on-year. But, again, we try not to focus too narrowly on like a couple of hundred thousand, right, or

on any one particular quarter. If you kind of look at Q2 and Q3, it's essentially kind of flat with last year. And last year, we had about 5 million global net adds in Q1, 5 million in Q2, 5 million in Q3 and then 8 million in Q4. Years prior, we've always had very strong growth in sort of Q1 and Q4 relative to Q2, Q3. And we think that pattern is going to happen again this year.

And so, again, we tend to focus on 12-month rolling, over 12-month rolling not only in a particular quarter because, as Reed points out, we've seen this movie before and we've been through these cycles of growth. And we think the sort of background fact of people adopting Internet entertainment including increasingly more international adoption is going to drive really strong year-on-year growth in international with U.S. hanging out in that 4 million to 5 million net additions band that it has been for the last four or five years.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

All right. One final sort of segue on to bigger things. So, has the results or any learnings from this quarter caused you guys to change at all your internal forecast longer term for either sub growth or revenue growth or free cash flow?

A - David B. Wells {BIO 17034721 <GO>}

No. But as Reed indicated - David, I'll take it again and others can chime in. But the business fundamentals, the on track for 10% operating margin, we indicated we do have some foreign exchange headwinds that kind of pushed us towards the bottom end of that range. But everything else is sort of tracking according to our target and plan. And so, again, we feel pretty good about it. Obviously, when you have sort of 1 million net adds, we are going to manage within the band of marketing spend and other things to protect that operating margin growth in the short term. But long term, nothing's really changed.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

All right. Don't worry, Greg and Ted. I've got plenty for you. But moving to the other elephant that was already in the room, just checking a bit on the competitive landscape. Obviously, a lot going on between Disney and Comcast and FOX and Sky. So need to check in and hear what you're thinking in terms of what impact on Netflix however that result turns out. And is any particular result better or worse for your own competitive fortunes?

A - Wilmot Reed Hastings

Yeah. There's a lot of new and strengthening competition with Disney entering the market, HBO getting additional funding, the different French broadcasters coming together. So that's all normal and expected. So it is what it is. We're not going to be able to change it. And then our focus is on doing the best content we've ever done, having the best user interface, the best recommendations, the best marketing, all the things that we've been doing for many years in the past and we'll keep doing for many years in the future.

A - Spencer Wang {BIO 3251222 <GO>}

And the other thing I would add to that, Todd, is the market for entertainment is so big that there can be multiple firms that are successful. So you've heard us talk in the past about how we've been able to grow dramatically in the U.S. and HBO and other networks have also similarly been able to grow at the same time. So it's a very large market.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

And our programming, we've always been focused on keeping people entertained and satisfied on an absolute basis, not relative to any competitor. So really by keeping an eye on our members and our consumers, we better serve them than hyper-focusing on competition.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

So one of the most frequent sort of investor questions related to this topic is access to content, licensed content particularly from Disney and FOX. Let me start with this very specific one. There is a wide, wide variance in degree of opinion on how much content on Netflix comes from off-network licensing Disney and FOX content. Care to narrow that down for investors? And you can give us some sense of just – both from a availability perspective and maybe from a viewership perspective how much is there?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

No, I don't want to narrow it down any more than it is. But I would tell you that it's been a number that's been on the decline for several years. You should think about it – the way we've looked at this long term is that our competitors will want that content on their own services. That was the bet we made a long time ago when we got into original programming. And every year since that, we've been doing less and less off-net business with Disney and FOX. And our bet is that long term, they'll want all of their content on their service. In the short to medium term, we're still licensing content off-net from them. And they're also producing original content for us like Nurse Ratched from FOX or the Marvel series from Disney.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Right. I know you've answered this question, Ted, I think, the last two or three quarters consecutively. But I got to ask it again. Any reason to expect those types of sort of original shows that you get from Disney and FOX to change given the new information from what they're doing?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

No, those shows are for us to cancel. And we're super happy with the performance of them so far. And the Nurse Ratched and some other FOX original titles are still upcoming.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

So speaking of your own originals, yeah, I wanted to touch on a couple of sort of relatively newer areas of focus for you and just check in and see how's it going. So one is unscripted, right. And you talked about this last quarter. It's been a sort of recent elevated

higher priority for you guys. How's that going? What's your experience been? Is it being enjoyed by your members as much as you thought?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Yeah. And we're super excited about the variety of the shows and how they're landing with consumers. Similarly, we thought a long time ago that the unscripted networks are also going to want to keep their own content for their own services. And we started investing in our own unscripted programming and have had some really great out-of-the-box hits with Nailed It! and Fastest Car and Queer Eye that are doing great with our watchers relative to building an audience. And also you saw Queer Eye did quite well at the Emmys, the nominations announced last week. So we're really excited with the progress and the speed to market we've been able to do our unscripted shows at really high quality.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

On the original movie side, another not quite so new area of focus but still more recent. What's your assessment of your progress versus where you'd hoped to be on that front?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

We're moving as quick as we can with and still delivering movies that people want to watch. So we saw - on the letter, we talked a little bit about the results of our romantic comedy, The Kissing Booth. There was much made in the press this summer about our romantic comedies have all been pretty successful. Set It Up just after The Kissing Booth. And so these are movies that are not really being made in the market much and we're doing and moving into those. But we're also doing a lot of the big event films with A-list directors. And these are long-lead production times and we're really excited with the way they've been delivering in terms of viewership. And we think that we'll see similar trends that we saw in television, but it'll take another year or so as we get into it.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

One final one I wanted to check in on, which will allow us to move forward here was what I'll call non-English language for lack of a better word. It seems like you're making more stuff in other places of the world. It seems like that's having success all around the globe. I just wonder if you could confirm that and talk about your own assessment of the returns you're getting on those sorts of program investments.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Yeah, similarly, fast ramp up and early success. So we've been producing shows that are incredibly relevant in their home territories. And the nice windfall is that they get viewed all over the world. So we saw that recently with The Rain and Dark. Certainly, in India, we saw great success recently with Sacred Games that really excite the market. And these are places where our global businesses play well too. So it's really, I think, accelerating the brand perception of Netflix as not just an out-of-towner but someone who's producing content that you care about in every part of the world. Upcoming this year we have new seasons of Las Chicas del Cable from Spain, Ingobernable from Mexico. We have a new show from Spain called Élite coming out in Q3, Ghoul in India coming out in August. And

these are shows that are produced at a level that are really high that consumers get really excited about. And it helps them get really excited about Netflix if they're not quite sure who we are yet.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Right. So now that we've moved on outside of U.S. and the Western world, could I check in just a little bit just specifically on Asia? And carve out India for a second because I'm going to come to India specifically later. But just to Asia as a huge reason - generally, I think we've talked in the past how the content tastes there a little different. The business model, you were hoping to find the exact right formula. How is your growth going in Asia generally? What is driving it? Is it at a similar pace, at the same stage other markets in the world? Any deeper info you can give us on that part of the world, anybody?

A - David B. Wells {BIO 17034721 <GO>}

Reed, why don't you take it?

A - Wilmot Reed Hastings

Sure. I'd say, Todd, we're starting to turn the corner in many of the nations where our viewing is climbing up as we're continuing to improve the programming. And when we get high viewing in every other market, that has brought in an era of fast growth. And so we've seen that. It's very country-by-country. I'll include India in the description and say we're really pleased with the progress of tracking we're making since we launched two and a half years ago. And we just have a lot of work and a lot of opportunity ahead.

A - David B. Wells {BIO 17034721 <GO>}

And, Todd, the only annotation I would say is, look, it's still early. We launched with a very sort of a skim (00:13:23) model approach and we've augmented that, right. We're adding payment methods. We're adding more content. We are working on all the playbook that has been successful for us in other markets of the world. And you see that through increased investment. And so that sort of last wave of expansion for Netflix is still relatively early. And that's affecting our growth numbers. It's affecting our levels of investment as well where our other markets are sort of growing in profit that actually those markets collectively are growing in loss. And we have more growth in the profitable markets than we do in the loss markets and that's what's growing the overall margin.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

And we've been really thrilled with our original production of anime that's being viewed quite pan-regionally throughout Asia and of course in Japan. Our scripted series and our unscripted series like Busted! from Korea or Terrace House from Japan are viewed throughout the region and are building brands bigger and bigger.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

And so thank you for sort of carving out India separately only because for a number of reasons, right. It's such a place with huge potential. I think numerous executives have been quoted in various places recently talking about the potential there. You've got some

new original shows there. So specifically in India, if you could dive a little deeper into where you are on the growth curve there, how you see the path to success and how big that could be for you in the next many years.

A - Wilmot Reed Hastings

Well, Todd, we're way behind YouTube, Hotstar. Those are really the leaders on the Internet. And there's so much TV viewing, that linear TV that could be Internet viewing. And the advantages are tremendous in India for Internet viewing because you don't get the app load that you see that's so high in all of the other platforms. So Netflix is having great success getting established, getting a reputation going. And with this triplet of Lust Stories, Sacred Games and Ghoul; we're really getting some nice momentum in our India growth. Now we're still, as David said, a niche product. We've got a long way to go to expand languages and many other aspects to be able to cover - be a broad Indian product. But in terms of our beachhead, I'm very pleased with what we've been doing.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Greg, there seems like there's some maybe seemingly obvious particulars about the Indian market from a product perspective that might be peculiar. How much of that is just from the infrastructure that exists and the affordability in the marketplace? Is that true? And if so, what have you got up your sleeve to try and make Netflix easy for everybody in India to enjoy?

A - Gregory K. Peters {BIO 17539678 <GO>}

There are definitely a few specific things that we're doing there that get to payments and how signup has to happen. We just rolled out some improvements on the signup flow on TVs, so you make that easier for nonmembers to become members in that dimension. But actually, a lot of the work that we do that helps our members in India is actually applicable in some sense globally as well, whether that's more efficient encodes to make the viewing process higher quality, start faster, that obviously is great for our members in India, but it's great for members around the world.

Downloads is another great example where we rolled out downloads for when you don't have great connectivity or you don't want to use the data in your data cap. Now, we've just actually rolled out the next iteration of that smart download so we can make that process even more fun and easy by having the episodes that you watched automatically delete and get replaced by new episodes whenever you come back on a WiFi network. So it's a mix of both India-specific and just globally relevant.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Yeah. In there, you talked about payments and just that whole stream. It's a question that comes up a lot with me with investors is just the thought about the affordability of the products relative to relative incomes. It comes up a lot in India. I'm going to broaden the question to just various places in the emerging world. How much room do you guys feel you have there in India and other places? Do you sense you're reaching a limit in any sense in terms of the utility of the product compared to alternatives and customers' ability to pay that would affect retail ARPU's any time over the near horizon?

A - Gregory K. Peters {BIO 17539678 <GO>}

I would say we're far from reaching a limit in terms of the addressable market given the pricing structures we have right now. We got a lot of room to grow in a reasonably affluent part of the society in India and other markets around the world, so much more runway. But having said that, we're constantly testing our pricing models, what pricing strategies work best for our members around the world and trying to find what features, what tiers we can add to make that both a revenue-positive but also a consumer-friendly and consumer-fair kind of approach.

A - David B. Wells {BIO 17034721 <GO>}

And, Todd, just to build off that a little bit and we're talking about India a little bit as homogenous. But breaking this apart, Reed has mentioned it, Greg's mentioned it. We may have an issue where there's three or four different sort of growth patterns within India in terms of different demographics, different segmented groups as we address one segment and then we start addressing another and so forth and so forth. And each one has a specific set of challenges with it and we're in the early days of sort of that first segment. So expect more from us in terms of getting into segments two, three and four.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

And I do think that the price point is mostly relevant to the value proposition. Are Indian consumers finding a lot to watch on Netflix and having a great time doing it? And if they are, that price point becomes more of a value proposition than a premium proposition.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Just picking up on that, one statistic that you guys sometimes mention and sometimes don't - I don't think I saw it in the press release - was the notion of engagement and as one good perhaps indicator of value received by your members. Any comments on where engagement, I guess, defined as hours streamed, hours streamed per member sort of stood this quarter? Is it still growing in line with content growth? Any...

A - David B. Wells {BIO 17034721 <GO>}

It is indeed still growing, Todd, on a year-over-year basis. Our viewing hours, mostly measured by median view hours, is growing. So we're super excited about that. And we're still a small fraction of every society's overall viewing. So I think there's still room to grow there.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Got it. One more on pricing just because I know you're always testing. We all know that. But one of your tests got picked up in the press. We actually stumbled across it. This idea of an ultra plan seems to be a test for HDR viewing that you're experimenting with. Just any thoughts you want to share on the theory behind that and the marketplace acceptance you think might exist for that type of a plan?

A - Gregory K. Peters {BIO 17539678 <GO>}

I'd say more generally rather than speaking specifically to end results because that's still very much in progress. We want to test at both ends of the spectrum here and try and figure out ways to add more value for those members who might see that as being good value while we're testing its more accessibility, how we create a way to access Netflix for a broader group of people. But a test that's still in progress and no results to discuss at this point.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Fair enough. So another way that you've been going to market increasingly it seems is with these partner deals. Maybe there's a better internal word for them. And they were mentioned again in the shareholder letter. Would love to check in on a couple of things on that. So first of all, is anybody willing to tell us roughly how important these are to your net add growth, to your overall subscriber base? Any sense of proportionality there other than what you said in the letter, which is basically a supplemental channel but the majority are still direct?

A - Gregory K. Peters {BIO 17539678 <GO>}

No, I think I'd reiterate that that the vast majority of our acquisitions still comes by consumers signing up directly with us. We were fairly new when it comes to these partner bundles. We're excited and optimistic about it. So I think that that will grow as a percentage of our acquisition. And what we're really excited about is it actually allows us to sort of more efficiently address different consumer segments. So let's take the U.S. for example, a market we've been relatively well penetrated in. By doing a deal like with Comcast, it allows us to put the application on the set top box where consumers that might be less early adopters or are more late adopters are already watching traditional television. By being included in a bundle, we get to remove a separate purchase decision. We get to eliminate the signup flow. It just makes it super simple and easy for consumers to sign up via that mechanism.

A - David B. Wells {BIO 17034721 <GO>}

And, Todd, just to be consistent with what we've said in prior quarters, it is a growing element of our acquisition, right, as Greg said, as we penetrate into demographics and established markets that may not be on the early part of that S-curve of adoption and also our newer emerging markets where partnerships may allow us to do things like partner billing and tap into consumer trust that's a little bit earlier in the cycle than if we establish that ourselves.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Is there any feedback you're in a position to share from the partners themselves in terms of how these programs are working for them? Not to single out, T-Mobile comes to mind just because they've been added in the States the longest. But anyplace in the world, you characterize their feedback to you.

A - Gregory K. Peters {BIO 17539678 <GO>}

Yeah, I think it's something that's very important because obviously we want a sustainable model around us where it's adding - it's valuable to the partners, perceived as valuable by

them and supporting their business so that they'd want to continue to invest in it and expand it. And market by market, it's different. But it's either a differentiation strategy where our partner is seeking to position themselves slightly differently. But oftentimes, it's just actually a way of them communicating to the consumer the value that they're investing in their network or the quality of service and like that. And having Netflix and the amazing content that we have and having a really high quality experience with that is a great way of just telling that story to their customers and their customers to be.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

It creates a great narrative that they're a good video source because when you're talking about Netflix, it becomes the symbol of a great data system, right?

A - Gregory K. Peters {BIO 17539678 <GO>}

Especially when you think about the - we're trying to be super innovative on the video quality and audio quality and all of those things that you unlock by having a great network and a great service.

A - Spencer Wang {BIO 3251222 <GO>}

And just to add on, Todd, we've been doing partnerships with other partners for many, many years. And we've had many multi-year relationships with many of our different partners. So as Greg said, we want these to be sustainable. And because we've had these for many years, I think you can extrapolate from that that they're successful for both parties.

A - Wilmot Reed Hastings

And, Todd, it's not a radical thing, MVPDs bundling another network. That's pretty well-trod territory on their side.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

One of the things that these partnerships give to you is also some more sort of marketing investment which is done on your behalf by them. Coming into the year, one of the themes that I interpreted from you guys was a little bit relative increase in the emphasis of your own marketing investment behind your content and your service. Just checking into that. And I guess we've seen that in the financials too. So just how's that going? Are you seeing the returns that you hoped for? And any specifics there? Can you maybe help - give us some examples of specific types of marketing programs and how you measure your investment of that where you're spending these incremental dollars?

A - David B. Wells {BIO 17034721 <GO>}

A couple of -

(00:25:31)

A - Wilmot Reed Hastings

We're very pleased with the growth and our ability to invest. A lot of it is behind title brands and seeing how do we help title brands really maximize their potential within the overall system. And we're doing lots of tests trying different methods in different countries, learning what's the most efficient ways to build demand for a title. So there's tremendous amounts of learning going on there. And then we're also doing acquisition marketing and learning on that side. And, David, did you want to add to that?

A - David B. Wells {BIO 17034721 <GO>}

No, I think that's great. Just to remind Todd that it's been a while. We've been out of the sort of we spend this much on marketing and we grow this much directly in a quarter. Only a fraction of our spend is oriented around direct acquisition. What Reed is saying is like the majority of the marketing spend - call it 80%, 85% - is oriented around building title brands. And we've got good evidence that we can do that. We're just parsing through what the most efficient mechanism is to market those titles and also where the right amount of spend is as well as we grow our content library.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

And what we see a lot is that the channels themselves vary around the content itself too. So learning more about how to get more and more refined about which channels for which content get the best results is the things that we're learning right now.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

And, Ted, were you pleased with the Emmy nomination campaigns?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

I was thrilled. I was told we had - we took the record obviously for the most - but the thing I was most proud of is we had 40 different shows nominated, kind of give you an idea of the kind of different variety of things that we're doing, scripted, unscripted, comedy, drama, talk shows, everything across the board. Everyone was represented. It was 40 shows worth of very happy people last week and millions of fans around the world too. So...

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Well, here comes the world's most inelegant segue. But being respectful to your shareholders, the single most popular question I got in prep for this - so I'm going to share it with you out of duty to that, I'm sorry, was revolving net neutrality. And so I guess we have a new administration relatively or not that new. But between that and some...

A - Wilmot Reed Hastings

Around the world, net neutrality has won as a consumer expectation. And some countries have net neutrality laws, other countries don't. But broadly around the world, consumers have the expectation and ISPs are delivering it. So I would say the net neutrality advocates have won the day in terms of those expectations. So we don't see any changes to that in the U.S. or other countries. So it's quite a positive outcome for changing cultural expectations in a positive way.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Okay. Flipping back inelegantly to my more core line of questioning. And speaking of big investments, Ted, I didn't give you a chance yet to - you've got some big new partners in terms of - for your producers on overall deals. It caught the attention of investors, obviously. You have your Ryan Murphys and your Shonda Rhimeses and your Jenji Kohans, not to leave out anybody. Help us think through...

A - Theodore A. Sarandos {BIO 4812832 <GO>}

(28:46) most recently.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Can you help us think through - are there more of those to come, A, that's one question. And more deals like that and more people like that. And sort of secondly related, what is the timeline? Has development started from any of these resources? And how long before we see the output of their work on - starts to show up on Netflix?

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Well, it's a great question. And you should think about the - it's a pretty rare creator who has an ownable sensibility, who produces a lot of content, prolific and successful. People like Shonda and Ryan and Jenji and Jason, they have a brand and they care about the brand and they want to create in that brand and they want to create a lot. So we could give them an infrastructure to do that at Netflix because we have a great history of connecting an audience for all those different shows. So that's not true of all creators, but it has been with the shows that we're doing so far. And we will probably do more, but it is a pretty rare breed of creator.

And then we just physically moved Shonda into her new home here at Netflix and we're thrilled. She has a couple of shows percolating now that we can't announce yet. But we're really thrilled with the direction she's going. Ryan's finishing up his work at FOX and then he'll be full steam ahead. Remember his last two shows at FOX are going to be our first two shows actually with The Politician and Nurse Ratched. So we're in the Ryan Murphy business in a big way. And then Jenji going from Weeds to Orange Is the New Black to GLOW was exactly what I'm talking about, about being prolific and successful. So we're really thrilled.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Right. Moving, David, to your very specific world and a popular question I received. And you answer this every quarter. Just regarding your continued use of debt to finance your current free cash flow deficits especially in an era of rising rate or current environment of rising rates, just need to check in and make sure we understand your logic and your continued ability or plan to finance the company and the future deficits (00:31:01).

A - David B. Wells {BIO 17034721 <GO>}

We continue to see debt as the most optimal choice, the most cost-effective source of capital for the company. Obviously, we'd love to get to that point where we're organically

and self-funding content. And we do see a point where we can get there. But until we do, we see debt as the right choice in terms of cost of capital.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

And another popular question - I'm getting through as many as I can before Spencer tells me time is up. So here's another one and probably for either Ted or Reed. You guys get this a lot. Investors still want to know your desire or appetite for sports type of content rights, for news-oriented type of content rights or for other expansions of your platform, you either get into audio or gaming or selling other people's products, any of those sorts of new genres or potential expansion theories. Where are you on those?

A - Wilmot Reed Hastings

No change in our long-term views that have been, as you referred to, expressed over and over. We have such an opportunity in movies and TV shows of many types around the world that it's consuming every bit of energy and excitement that we have.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

Got it. Let me, if I can, move to what I think might be sort of the seminal question - two questions for long-term Netflix shareholders; which is really, okay, you got about 130 million global members now. How long is it going to take you to get the next 130 million? And if you double your members, are you going to need to double your spend in content and marketing to attract and retain them?

A - Wilmot Reed Hastings

Well, it's kind of hypothetical to think about the P&L structure. We'll learn as we go. We've been very attentive to all the key factors which is we want to invest enough on content to make our subscribers incredibly happy because that's how we grow. So it's a really smart investment for us on the content side. We want to invest in product and marketing to make the whole service better to make the shows be more aware. We also want to steadily increase operating margin over the next several years. And so as an example, we've got some adjustments to make because of foreign exchange rates and we'll make those adjustments and we'll grow into that.

So think of us as continuing every year to figure out how we make certain adjustments to keep the operating margins growing, the subscriber base and revenue growing. And that's been the basic way we've been operating over the last several years. So it's more of the same. And in terms of the dashboard as several years out on when we double, the answer is not soon enough. We're always pushing hard to figure out how can we get even more growth. But we're awfully pleased with what we've got too.

A - Spencer Wang {BIO 3251222 <GO>}

Todd, I think we have time for one more question.

Q - Todd Michael Juenger {BIO 17171389 <GO>}

All right. So I guess I'll use that to sort of just expound on the big dartboard I just asked and maybe start with Greg and then anyone else who wants to comment. When you think about the product itself which is the underpinning of the belief you have in the growth, what's on your short-term and long-term list of things that you think your members most desire or would move the needle most from a product perspective, from a content perspective, from an overall pricing and value perspective and therefore drives your agenda - I guess each of you - over the rest of this year and into the coming decade?

A - Gregory K. Peters {BIO 17539678 <GO>}

It's a long, long list. We want to make really almost everything better about the product. I'll just sort of highlight one that's fun and happening right now. We talked about some of the improvements in the mobile UI and smart downloads. But I don't want to leave out TV. And with all of this amazing content that we are bringing out, we've been working really hard over the last several months and quarters even testing and researching how do we make that TV experience faster, more fun, easier to find the stories that our members will love. And we're actually going to roll some improvements out to that experience and make that better starting tomorrow. So starting this week, you'll see those. And that's what we expect to be a long line of incremental improvements that make that experience even greater for finding the stories that you love.

A - Theodore A. Sarandos {BIO 4812832 <GO>}

Okay. I'd say in the short term we've got - I've got the great pleasure of trying to make people very happy. And in the short term, we've got new seasons coming up the second half of this year of Orange Is the New Black, Ozark, Iron Fist, Daredevil, Narcos, the finale of House of Cards, the follow-up series for Making a Murderer. And we have some brand new IP coming up with new shows like Insatiable; Maniac with Emma Stone and Jonah Hill; Disenchantment from Matt Groening, the creator of The Simpsons, doing an animated comedy for us; a new show from Greg Berlanti's company; The Chilling Adventures of Sabrina; a spinoff of Riverdale that's been hugely popular for us. And that all ramps up to bigger and better feature films too for our fans around the world starting with The Christmas Chronicles from Chris Columbus later this year and Bird Box from Sandra Bullock with the great Susanne Bier directing. That will lead us into next year where you have movies from Martin Scorsese and Alfonso Cuarón and all these fantastic directors. And the opportunities there are just limitless.

A - David B. Wells {BIO 17034721 <GO>}

And then for me and I'll let Reed have the honor of wrapping this up. But I would say we've got 130 million members. And the prospect of adding whatever that is, 100 more million, the next 130 million; all of those folks enjoy connectedness. And as we grow to enjoy more stories that are sourced from wherever in the world, I think the ability for all those folks or a great portion of those folks to enjoy and see a story and discuss that story in the same moment is great. And Netflix being an enabler of that will continue to do that. And I look forward to the \$8 billion on content growing from here. We think we can grow operating margin, but we're also going to grow content spend which will enable more of that content.

A - Wilmot Reed Hastings

And, Todd, for me it's about connecting the world and sharing the stories all around the world. I think we've got so much more we can do with that as we learn the various arts of dubbing and style. And I think that'll make a really profound contribution to the world in addition to just entertaining everyone which is very joyful to work on.

With that, let me thank everyone for participating in the call and look forward to spending time with you guys and investors over the quarter. Thank you very much.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2021, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript