Q2 2019 Earnings Call

Company Participants

- Greg Peters, Chief Product Officer
- Reed Hastings, Founder and Chief Executive Officer
- Spencer Wang, Vice President, Finance, Investor Relations & Corporate Development
- Ted Sarandos, Chief Content Officer

Other Participants

- Michael C. Morris, Analyst

Presentation

Spencer Wang {BIO 3251222 <GO>}

Good afternoon. And welcome to the Netflix Q2 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 will be making forward-looking statements and actual results may vary.

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

Questions And Answers

Q - Michael C. Morris {BIO 2323139 <GO>}

Thank you, Spencer. Good afternoon. Let's jump right into the results and the member variance from guidance in particular. What changed during the quarter versus the outlook that you provided that made such a significant impact this quarter and you did mention the content being, perhaps, a factor. I think that's really something we haven't focused on in the past in terms of driving the cyclicality. So, maybe if you could talk about those things?

A - Reed Hastings {BIO 1971023 <GO>}

You know when we're forecasting, Mike, in the beginning of the quarter, we make our best estimate. And as you can see over the past three years, sometimes we are forecast highs, sometimes we forecast low. This is one where we forecasted high. There was no one thing. And if I think about three years ago, we were also light and we never really were confident of the explanation, then we were $2 billion in quarterly revenue. Now, we're going on $5 billion. And so, it's easy to overinterpret the quarter membership adds, which are a bit noisy. So, for the most part, we're just executing forward and trying to do the best forecast we can. Do you want to add anything to that Spence?

A - Spencer Wang {BIO 3251222 <GO>}

Yeah. Thanks, Reed. Maybe I'd just add the fact that when we think about those paid net add forecast. It's really about the marginal growth. Mike, on a subscriber base, it's over 150 million members. So, we're talking about, plus or minus 1%, 2%, 3% in growth rates on subscribers on an annual basis that are growing over 20%. So, if we look at the trailing 12 months, we grew our member base by over 27 million members. If you take that forward to where we think we'll be at the end of Q3, we think it we will be on trailing 12-month basis over 28 million members. So, we're really playing for the sustained increase in growth in our membership over time and there will be some quarter-by-quarter choppiness along the way based on things like seasonality and content slate and so forth.

Q - Michael C. Morris {BIO 2323139 <GO>}

Could you -- can you provide a little more detail, perhaps, on the gross add versus the churn dynamic in the quarter. Clearly, there is the pricing dynamic, I want to get too as well, but maybe we just back up and look at gross adds versus churn and how that resulted in the net?

A - Spencer Wang {BIO 3251222 <GO>}

Yeah. Sure. I mean, generally when we looked at it, the slowdown in subscriber growth was across all of our regions. So, we talk about our kind of top of funnel or gross adds. We saw that slow down across the Board, which indicates to us some level of seasonality and kind of the overall, as we say, the kind of timing of the content slate. And also, frankly, maybe a little bit more pull-forward of our subscriber growth from Q2 to Q1, because we had such a strong Q1 with 9.7 million paid net adds. But we also did see in regions where we increased prices, we did see some elevated churn rates and lower retention. So it was a combination of those two things. We think the primary story was around seasonality and timing, and nature of our content slate, but pricing played a factor.

Now the good news in all of that, as you saw, Mike, I think, in the letter is that, in the first couple weeks of Q3, that growth has reaccelerated again. We're seeing both that top of funnel growth in acquisitions. We're also seeing improvement in those churn rates and retention back down towards those pre-price change levels. So, overall, encouraged with the trends and with regard to that pricing piece too, it's worth kind of reminding ourselves and it's all -- that's all very revenue accretive. So while there may be some short-term slowdown in subscriber growth because of pricing, that increased revenue is very good for our business and ultimately for our members, because we reinvest the bulk of that back into great content and great product experience for our members.

Q - Michael C. Morris {BIO 2323139 <GO>}

Can we talk a little bit about that pricing cycle and where we are right now? So two things, I guess, specifically. In the US, by June had the entire membership base seen that price increase such that there wouldn't be a lagging impact in the September quarter. And then internationally, obviously, it's much broader. Can you highlight any particular markets?

Anything you can help us size the portion of your member base that is processing through those pricing increases?

A - Spencer Wang {BIO 3251222 <GO>}

Greg, do you want to take that or do you want me to take it?

A - Greg Peters {BIO 17539678 <GO>}

I'm happy to do that. So, in the US situation, we're through all those notifications. Obviously, in the international perspective, we've got different markets in different places, but I would say just in terms of helping you size that. I mean, we built obviously in that into our forecast for Q3. So, those effects we've already tried to account for and categorize in that forecast.

Q - Michael C. Morris {BIO 2323139 <GO>}

Okay. Great. And then, Spence, one other question with respect to the letter on the outlook. It's the second consecutive quarter you've come ahead in operating income relative to your guide. You are maintaining the same full-year guidance. I know you referenced the marketing, but help us there with, again, maybe why the timing from your perspective forecasting hasn't been as clear, given that it feels that you would know when certain marketing was coming through?

A - Spencer Wang {BIO 3251222 <GO>}

Well, it's marketing, we have -- and Ted should chime in too, but we have some discretion as to when we choose to support titles and so we're really, when you look at the back half content slate that we have, we're very excited about with Stranger Things 3 already launching, but then shows like La Casa de Papel and Crown, and big movies in the fourth quarter, and Money, sorry, I already mentioned Money Heist, sorry, but there is just, there's a lot of content to support. So I think it was just really discretion of the team to move some and shift some of that marketing spend until later to the latter half of the year.

Q - Michael C. Morris {BIO 2323139 <GO>}

Okay. So some of these pressing topics covered a bit. I have to read, usually, we'll start with an overview question and so, I guess, we're halfway through the year now. This dynamic perhaps aside, any change to your view of the business strategically overall. And I guess embedded in that is touching on that question of your confidence about the growth outlook going forward and why an investor shouldn't look at this quarter and say, perhaps, the business is approaching maturity more quickly than we anticipated?

A - Reed Hastings {BIO 1971023 <GO>}

Yeah. I mean, if you look over the past 12 years that we've been streaming. In the beginning there was Hulu and Amazon and YouTube and Netflix, and we've all been growing at tremendous rates over the last 12 years and now it's really catching on in a big way around the world and we're having a lot of new competitors enter over the next year. And I think, our position is excellent. We're building amazing capacity for content, our products never been in better shape, and our rate of investment is extremely high. So, if investors believe in Internet television, which I think is easy one to get there, then our position in that market is very strong and all of the key things are coming our way in terms of again stronger content and a stronger service.

A - Spencer Wang {BIO 3251222 <GO>}

And Mike, if I could just add on your topic of maturation. I would just also point out that revenue growth did accelerate by 400 basis points in Q2 versus Q1. If you look at our guidance as well for Q3, I think, you'll see that trend continue as well. So, financially, I think, that's actually a sign that things are picking up or continue to grow very steadily.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. Thank you for that.

A - Ted Sarandos {BIO 4812832 <GO>}

Also, I'd just add too on a similar in the same vein is under show by show or film by film basis we're also seeing -- hitting new heights in terms of viewer penetration and audience reach as well.

Q - Michael C. Morris {BIO 2323139 <GO>}

Okay. Okay. Great. Let's expand the discussion a little bit. Greg, over the past year plus, we've talked about some of the partnerships that Netflix has struck with the traditional video on wireless providers. I understand each can be different. There can be different accounting treatments. But perhaps, can you give us an overview right now where we are on partnerships, perhaps, domestically in particular, how they're impacting the business, do they have any impact during the quarter, of course, which is, in general, what do we look like in terms of those impacting and where we might go from here?

A - Greg Peters {BIO 17539678 <GO>}

Sure. So, there is a long history of these partnerships starting back with sort of the simple device integrations, back to the Xbox and Sony PlayStation. But the latest incarnation as we sort of added more capability to each partnership from just simple device integrations and being able to access the experience to sort of payment integration and things like that, is this bundling that we are doing with Pay TV operators, with mobile operators, and it's a characterize where we are, we're still fairly early in that process, I would say, from a global perspective, but the bundles that we are doing are nice incremental accelerants to our acquisition, especially into a user population that may not be as tech-forward as the folks who sign up with us directly, they may not have a smart TV connected to the Internet in their home, they may not have an adaptor product like a Roku or an Amazon Fire TV, but they do have a set-top box from their Pay TV operator. And if we can put the Netflix application in a nice seamless integration into that set-top box, if we can then include the actual subscription to the Netflix as part of their Pay TV offering as a bundle. Then it makes it super-simple for those folks to be able to get the same kind of experience that our subscribers who sign up with us directly do and get the same benefits. So, we're going continue to expand those, we've got tons of opportunity, I'd say, globally around the world to add more and more partnership. So we're still fairly early stages there, but also our perspective is that we anticipate that that bundle acquisition channel is a nice supplemental incremental component, but a minority component of our overall subscriber acquisition process.

Q - Michael C. Morris {BIO 2323139 <GO>}

Okay. Let's turn a little internationally as well, Ted. Prior to the results today, data that we had seen indicated some strength in particular markets that seems content-driven strength in France and Germany, in particular, in Europe. Japan, South Korea, and Asia. Curious if you could characterize any particular markets that, I realize, you mentioned the relative weakness to guide was across the Board. But any particular markets seeing more of a tailwind right now, particularly a content-driven tailwind?

A - Ted Sarandos {BIO 4812832 <GO>}

Well, one that we'll be looking for starting this week is going to be in the La Casa de Papel that Spence just mentioned. This is our largest non-English show that we shoot out of Spain that plays throughout the world at a very high level. We also have Elite and Chicas del Cable from Spain that are enormously popular shows and new seasons coming in the quarter, and Sacred Games from India, which was a big driver for us in its first season dropping new season this quarter as well.

And in the past three months, with the release out of Germany of How to Sell Drugs Online, The Rain Season 2 from Denmark and Quicksand from Sweden. What's been amazing is they've been deeply relevant in the home country, travel the region very, very well and it found global audiences. So the three shows, I just mentioned from Germany, Denmark and Sweden have 12 million to 15 million global watchers. So we're seeing some real locally, regionally and globally relevant content coming from all over the world.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. You mentioned India, always a topic we like to dig a more into because the size of the market, of course. So, I guess, for Ted and for Greg also in this market in particular, as we approach the second season of Sacred Games a bit of a milestone, where are we on the content offering. I think you referenced some other markets where you can start with an original and get some traction, but you really need a certain amount of bulk to offer there.

So where are we in the content offering in India? I also know you mentioned or I've seen reference to five other shows particular series or projects that were green lit. And then, Greg, perhaps, tied in with the question about product pricing, you made a reference in the letter to some new pricing. Can you talk a little bit more about both the product and pricing in India in particular?

A - Ted Sarandos {BIO 4812832 <GO>}

Okay. Before we get into pricing, the only thing I'd add is that our -- we announced five new originals for India. The one we're also really excited about later on this year is Baahubali, which is our first step into a really large scale Indian original film. It's based on a film that was hugely popular a year ago and this is a series prequel, sequel model that we think is going to be incredibly popular in India. And we've been seeing steady -- nice steady increases in engagement with our Indian viewers that we think we can keep building on. Growth in that country is a marathon. So we're in it for the long haul and we're seeing nice steady progress.

A - Greg Peters {BIO 17539678 <GO>}

So we're expanding that content offering and seeing that engagement grow. We think that there's an opportunity then to be able to broaden the access to the service and so more people can enjoy that increasingly relevant content offering. So that's clearly the motivator behind adding this mobile tier offering, which we think is going to be a lower price point and in a market where the typical Pay TV package is under $5. We think we need to have a lower price offering to improve the accessibility. But also one that complements the existing tiering structure that we have.

So that's the primary motivator for that move, so we can broaden the audience that can love that content, enjoy the content that Ted's team is making. And that's great, because like when we launched Sacred Games Season 2 we have a bigger audience for it, that means we can create more social buzz and more excitement about that show. So we're doing that. We're also working on the partnerships we have in the market, because we think there are specific opportunities to improve accessibility via those partnerships as well.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. And Reed, a broader question, how do you view your potential subscriber base globally. I think a lot of us use the sort of broadband, connected broadband marketplace. But how do you see it? I would imagine you see it as larger than that. And historically you've given us the 60 million to 90 million member outlook for the US. Would you be willing to put some parameters on what you think the global opportunity could be or why wouldn't you?

A - Reed Hastings {BIO 1971023 <GO>}

Well, we do wonder in the fullness of time can we be as big as YouTube. YouTube is seven times larger than us roughly in viewing hours and phenomenal service, of course, it's free. So the real question is, can we produce enough content to, people are willing to pay for. If you look at benchmarks, it's about 700 million households that pay for television outside of China. So that would be kind of the equivalent of the US 100 million. So that's one established market.

Now, do we have enough content in each of those countries? Most of that is local content that gets consumed. But then Internet is capable of some very large customer basis, as you I am sure well know. So we just take it year-by-year and try to have our net adds continue to grow. We still think our net adds this year will be larger than last year. We'll keep pushing on that and what we want to do is just grow the net adds every year and then the future takes care of itself.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. I want to talk about a couple of broader strategic topics here. Reed, in the past you've clearly stated that you view your competition for consumers time pretty broadly sleep, video games, et cetera. The financial press though love this concept of streaming wars between Netflix and a number of existing and new platform. So do you think that streaming wars is a fair characterization of what the future holds for Netflix and for video entertainment?

A - Reed Hastings {BIO 1971023 <GO>}

Yeah. I mean, high level it is, certainly, all of Ted's world is very competitive. It's never been a better world for talent. They get to bit themselves off between us, Disney, Amazon, et cetera. So there's a real battle for who will pay for content around the world. But it's not a zero-sum competition. I think everybody gets that. People will subscribe to multiple shows. I'd wager that most Netflix employees are HBO subscribers. We love the content they do and that spurs us on to want to be even better. So it's a great competition that it helps grow the industry and the advantage of having something catchy like the streaming wars is it draws more attention. And because of that people consumers shift more quickly from linear TV to the streaming TV.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. Greg, over the past 12 months, you've spent, the company spent approximately $1.5 billion on technology. I mean, couple of specific questions. First, can you help us understand sort of the scalable part of that spend versus the incremental part of that spend and maybe to the extent you can quantify grade, to the extent you can perhaps talk about the types of things that would fit into one of those two buckets that would be great?

And I think, also a question that we get is really how your technology spend can be a competitive advantage in this competition for subscribers. So is there anything you can point to from the consumer perspective where you really feel like it's -- whether we see it or we just enjoy it that separates the Netflix platform from the competition there?

A - Greg Peters {BIO 17539678 <GO>}

Yeah. There's a lot there. So let me try and take it piece-wise. I would say, the majority of that spend we would say is a fixed cost investment which returns increasing benefits at scale. So as we grow our business, we get higher leverage off that fixed cost investment. There's a small portion of that, that I would say is sort of incremental to how we scale that -- you can think of that as either on the delivery cost side, we seek to invest on the content delivery side to make that more efficient, so that's a fixed cost. But then we obviously have certain elements of that cost, which just scales as we grow the business as we deliver more streams, right?

But a couple of examples on this. So you can see the benefits from a consumer perspective, just to pick a few. So one is when we think about sort of our end code efficiency and this is how we actually take the moving pictures that our creators produce and then reduce them into a digital form so that we can actually deliver them to a variety of different clients, a variety of different devices around the world in a wide, wide range of network conditions, back to like gigabit plus constantly reliable all the way to super flaky networks that we see in markets, let's say, in a mobile environment.

And so we try and make that encoding process so good that pretty much we're maximizing the capability that we have, the connection that we have to any given consumer in that wide range of environments at any point in time. So, obviously, that -- that's -- the consumer benefit is realizing just a good quality picture experience and more engagement and more compelling immersiveness in the content. So that would be an example of that kind of fixed cost return.

Q - Michael C. Morris {BIO 2323139 <GO>}

And Greg, about how many AV-Test do you guys have running currently?

A - Greg Peters {BIO 17539678 <GO>}

So I would say, in a year, we'll run, let's say, 400 is a good benchmark and these are situations where we're -- we have a theory, hypothesis, or how do we present a better experience which is more compelling to our users, which gives them a better experience, more engagement and we'll test it out. And then based on how the users actually use the service will determine if that hypothesis was correct or not. And obviously, the ones that work that are a better experience we'll rollout largely to our whole universe typically of users around the world.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. Another, a place you didn't quite mention was the user interface itself. We do get questions about discovery and particularly with all the content is being invested in. There is a survey that I just read about from Nielsen. Two-thirds of streaming users know what they want to watch when they go to the service. But another third look and they spend 8 minutes to 10 minutes according to the survey, looking for something to watch. So, as my question for you, does that seem right based on anything you've seen, but also is that a good thing or a bad thing, and where is the interface from your perspective to making that great.

A - Greg Peters {BIO 17539678 <GO>}

Sure. I mean, we obviously track those numbers, we have our own metrics that we use it around how our members engage with the service, how much time they spend in the discovery process, et cetera. So, we have our own view on that and I think the Nielsen numbers are -- they are good soundbite, but don't reflect the typical experience. And I would say, generally, I think, we're doing a pretty good job as evidenced by sort of our growth and engagement and general growth and subscribers.

Now having said that, we are bringing a tremendous number of titles to the service and many titles which people don't know, they haven't heard it before. So we have an opportunity to continually improve and get better and better and how we present the right titles to the right audience and in a way which is meaningful to them, which explains to them why a show is relevant to them and gets them excited about watching that. And so a lot of those 400, call it, AV-Test that we run in a year are around trying to figure out how do we do a better job, and we have a healthy roadmap of good ideas about how to make that better and better and we're excited about that. And we think that that is a competitive advantage. If we do a good job there, we can deliver a better service experience that unlocks the value of our content library in a more effective way.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. Great. Okay. So, I want to talk about some key content-related items and I think we know well-publicized topics that I want to get to. But first, Ted, can we just talk about your current strategic point of view on investing and I'm thinking about allocation of resources across a couple of vectors, global versus local market focus content, films versus series, and I think Netflix branded versus license. Just if you could tell us sort of from a high level where you stand and how you're splitting your resources there?

A - Ted Sarandos {BIO 4812832 <GO>}

Well, the one -- one of those three that cut across all of them is the original branded content versus licensed, which is producing the kind of programming that is locally relevant and globally important. And I think we've seen shows like Stranger Things right now that plays almost completely globally, performing off the charts in every country in the world. We saw similarly last quarter with Umbrella Academy, a show that is an incredibly global show.

So, there is plenty of content that is global and there's a lot of content that's very, very specifically local and we're balancing constantly between those two. And every once in a while you get something out of like La Casa de Papel from Spain that also becomes a global phenomenon that has nothing to do with what we've seen for, since the beginning of film and television that almost all content that travels the world is in English from America. And we're seeing those dynamics change pretty rapidly. But at the same time, it's a very large audience and about most of the English-speaking content travels. So, we're constantly doing those trade-offs between the two.

The overarching strategy that we're continuing to drive toward is over six years ago we got into original programming betting that the licensed program would be more and more difficult to come by and that may be the sources of -- of license -- of content to license for will be under different levels of strain. That has paid off, we think. We think it's been very important to the business to continue pushing down that road. So, the -- more international, more global, more original film. We also have a large investment coming up in animation that we will start to see some of the fruits from early next year. So, we're -- we think we're betting in all the areas of content that our consumers love.

Q - Michael C. Morris {BIO 2323139 <GO>}

Just a follow-up. Film has been something where clearly we've seen more volume and more focus at least on a relative basis. Can you talk about why film is incrementally important for the platform overall relative to the series. And is it fair to say that more effort has gone there because it certainly feels like it from our perspective?

A - Ted Sarandos {BIO 4812832 <GO>}

I would say more effort than in the past couple of years and I'd say more successful effort in the last than -- in the last couple of years, so that's what we've been most excited about. When you see a film like Murder Mystery hit an audience as large as it has, you start thinking -- we really aren't benchmarking against our ability to license pay-one movies. We're benchmarking against the consumer perception of what movie they want to see on Friday night. So that competition is for very large scale films, for very intimate Indie films and everything in between. And I think the team has done an incredible job this year in punching those films out into the zeitgeist becoming those real talkable moments like Bird Box, like Murder Mystery. We think in Q4 with Irishman and Six Underground that these are the kind of films that people just think about when they want to watch a movie and they're not -- not when they want to watch a Pay TV movie.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. So you mentioned this, Ted, and I'm happy to ask you and open it up more broadly.

A - Ted Sarandos {BIO 4812832 <GO>}

Yeah.

Q - Michael C. Morris {BIO 2323139 <GO>}

But, really, a big question about the high profile content coming off the service over the course of the next year or so. I think the first question is about impact and you addressed it a bit in the letter. But when we have The Office, we have Friends, we have the Disney-branded content in particular coming off the platform. So, again, you addressed it a bit. I'd love to hear any expansion on it. One is just how much of the viewing consumption does this makeup, either person by person, I think, there would be differences between the amount of viewing and the number of members that are viewing it for one day.

A - Ted Sarandos {BIO 4812832 <GO>}

Right.

Q - Michael C. Morris {BIO 2323139 <GO>}

There's also a domestic and international dynamic. And then also just the sort of historical precedent. You have had content like Family Guy, X-Files, things like that, that has come off. Help us with the precedent, how we should think about this?

A - Ted Sarandos {BIO 4812832 <GO>}

Since we started streaming 12 years ago, the consistent dynamic is that content comes and goes. The licenses come on, they expire, being competitive, they go somewhere else. That's been true. This is the kind of second round with the Pay 1 Disney films. Remember back in the day we used to license them through STARZ and had them on Netflix and it was a big swing off. Along with other -- with films from Sony at the same time.

So, we've seen the entire output from Fox. We've seen the entire Nickelodeon kids output come and go on the site. And we go through that by, we believe, by making these early investments in original programming and getting our consumer and our members much more attuned to the expectation that we're going to create their next favorite show. Not that we're going to be the place where you can get anything and to every time [ph].

A - Spencer Wang {BIO 3251222 <GO>}

We think there's more value in that proposition than there would be in the kind of low price aggregator.

A - Greg Peters {BIO 17539678 <GO>}

Mike, the only thing I might add to that is just, as Ted said, we've been planning for this for a long time. But when you look at our -- we don't have any overconcentration in any single studio or any single show. We talked about it in the letter any single show even though most viewed shows are single-digit -- low single-digit percentages of viewing. And there's going to be as content rolls off the service and when and if it rolls off the service, it's going to be over time. If you look out three, four, five years from now, that second run license content, there's still a very meaningful portion of what's on the service today that will still be on the service four, five years from today. So we're just going to continue to focus on our strategy of developing more and more original programming, and obviously, as Ted said, if there's second run license programming that's available then that's still part of the business.

Q - Michael C. Morris {BIO 2323139 <GO>}

Understood. Before we talk about that, the allocation of budget there, the international versus domestic dynamic for some of that specific high profile content that is coming off. Is the consumption of it and the availability of it consistent on a global basis or is this primarily a domestic phenomenon? How should we think about that?

A - Ted Sarandos {BIO 4812832 <GO>}

It's primarily domestic now. I guess, by way of example, we just recently added Big Bang Theory to a lot of our international territories. We've never had it available to our -- in the US. So I think it's international. It's more of a domestic-driven initiative today that in success we believe it will be international one day or two.

Q - Michael C. Morris {BIO 2323139 <GO>}

Okay. And then, of course, you're spending money on this content. So it's not like it's just leaving, you have resources being freed up, if you will.

A - Ted Sarandos {BIO 4812832 <GO>}

Absolutely.

Q - Michael C. Morris {BIO 2323139 <GO>}

When we talk about, though, the availability of product, there's one thing to take sort of iconic piece of content off the shelf and not have to have it recreated. When we think about redeploying that money and expanding your budget even further for originals, are there constraints on whether it'd be talent, any types of resources available or do you think that there is ample opportunity to go out and redeploy that?

A - Ted Sarandos {BIO 4812832 <GO>}

We definitely think there is ample opportunity, particularly across film and television. Like I said, a couple of years ago we are not investing in animation at all and today we're investing very aggressively. I also think that the emergence of the next global storyteller being from anywhere in the world certainly opens up that opportunity and we're becoming much more seasoned producers all over the world to do that.

Q - Michael C. Morris {BIO 2323139 <GO>}

Okay. Great. Now, you are investing more in your own capabilities, of course, and Greg, I think, that one thing that we don't talk about much is the technology side of the studio and production. Is there an opportunity for Netflix as a technology company in addition to being a media company to take advantage of some opportunities to be a more efficient studio, a better studio in terms of what you're working with Ted on?

A - Greg Peters {BIO 17539678 <GO>}

Yeah. So, if you think about the number of titles that we are producing and the strength that we have in technology analytics. We do think that there is an opportunity back to the discussion we just had around, making a fixed cost investment, either in terms of efficiency benefits or outcome benefits, it's just the quality of the dollars they get to the screen that impact the user across the range of titles that we are producing.

Now, I would say, it's early days here. So we're trying to replacing a bunch of bets and we'll see sort of how those bets play out, but just to give you a sense of, make a little bit less abstract and more concrete. When you think about after show or a movie has been made, you make a trailer to promote that, we use those on service, we use those off service, right? And typically the first step in that process is someone goes through and they look at all of the scenes in that show for example in the inventory like what are the characters, what's happening there? And that sort of provides us index, so that they can actually take that material and then from that use that index to assemble in the creative process what's a compelling trailer.

Well, we can increasingly use automation as a technology investment to basically do that indexing process so that our trailer creators can really focus their time and energy on the creative process taking the result of that automated process and putting together something which is super compelling tells the story of what this show in an authentic way and makes it more attractive to viewers. That's just one example of the kind of investments that we are making that we think have that kind of returning leverage against scale.

Q - Michael C. Morris {BIO 2323139 <GO>}

All right.

A - Ted Sarandos {BIO 4812832 <GO>}

I would just add that being an efficient producer is a very good thing to do, obviously, but being an efficient distributor to being an efficient marketer is P&L changing. So those are the way to think about. We're working on all three of those things at the same time.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. I want to move a little bit to the reporting and the granular reporting of data that you referenced on the last call. One of the places we're seeing it more clearly is in the UK with the top ten list. So my two questions are number one, can you share any results from that UK top ten list, number one? And number two, what can we as consumers or members expect going forward? And then I have one follow-up with respect to what it means for the talent, of course.

A - Ted Sarandos {BIO 4812832 <GO>}

Well, the one thing we are -- we said this in the last call as well that we are being much more transparent with the creators and increasingly with the public in terms of what's being viewed on Netflix, mostly because I think people use a lot of different inputs to figure out what they want to see and popularity is definitely one of them. And we're trying to figure out how to balance off popularity against some of the other personalization tools to give people that opportunity that they want to see, but everyone else is watching in their country, in their city, in their town, that we can present that to them in a way that helps them make better choices. But, in general, I think, we're still testing the best application of that. It's still very much in active testing mode.

A - Greg Peters {BIO 17539678 <GO>}

And I'd just want to comment. I think we feel like there's a greater way to actually enable that personalization but enable popularity signaling for the users is one. It's just basically looking at the folks that use that popularity as a factor in the decision-making they take on what to watch next and making sure that those popularity signals are available and very present for those users and for users who don't seem to want that, then we can sort of make those less present.

A - Ted Sarandos {BIO 4812832 <GO>}

Yeah. And there is an example of a very granular piece of data that we shared recently was in the first four days of Stranger Things 3, more than 18 million people watched the entire season. And why share that number? Because the very next follow-on to that was, wow, I'm one of those 18. I want to tell my friends about it or, oh, my God, I want to be one of those 18 or are you one of those 18. So it creates a lot of excitement in the fan base when you can give them some data to chew on.

Q - Michael C. Morris {BIO 2323139 <GO>}

So from a public perspective or from a member perspective, should we expect more consistency in that type of data or is it going to be one-offs on selected items that you feel are valuable?

A - Ted Sarandos {BIO 4812832 <GO>}

Yeah. I think we'll be increasingly transparent with producers and then event -- and over time more and more. I really like it's important for us to help condition the market to understand what the viewing data is. So it's not being compared apples to oranges against things that are not similar. And right now, if we start publishing tomorrow, we'd be the only streaming service doing it.

Q - Michael C. Morris {BIO 2323139 <GO>}

Right. Right. So, the value of this data to hide your content partners, content creators. As you create more of these large budget films you have actors rather talented historically, perhaps, were compensated on box office performance. How are you approaching that when you want to make these big budget films and you want to incentivize talent and maybe the flip side to that is, perhaps, you have a little protection if the film doesn't do as well in the traditional model, is there a way that this data starts giving you both the incentive and the protection?

A - Ted Sarandos {BIO 4812832 <GO>}

Yeah. I think it in, what we're trying to do is, it's a very new model, but particularly for box office friendly talent who want to make their next big film in Netflix. So we have to figure out a model that in success, how would they be compensated. The fact that it's guaranteed, there is some discount applied for that and if I did it, it's paid out over a quicker period there'll be discounts applied for that. But ultimately we want the economics to be pretty neutral or at least or similar to what they would be, if they had to begin film in the theaters. And that's what we negotiate film by film, talent with actor by actor.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. I'll open this up to anyone, Reed perhaps. Looking at the product placement or rather product partnerships for Stranger Things. Certainly very high profile a lot of buzz, very broad. In the letter, you reference it is being more about building the product itself versus monetizing, does it become a monetizable part of the business at some point or put differently -- expand a bit on the benefit of doing that and how that might be broaden to other properties?

A - Reed Hastings {BIO 1971023 <GO>}

Well, we're monetizing it today in more membership growth. The focus is get more people excited about Stranger Things so they join Netflix, they tell their friends about it. So this year we will add about $5 billion of incremental subscription revenue, which is almost all of gross margin and that's faster than any entertainment company has grown in the history of the world.

So what we want to do is keep that engine going, keep that subscriber engine going and not get distracted with alternative revenue sources, which is just going to add up when you're growing $5 billion a year. So the core focus is, create all these merchandising opportunities, tie-ins, touch points, so that you feel the Stranger Things energy so that more people joins. So, I think together as we do monetize all that. It's just we're monetizing it through our giant engine rather than through little sidecar vehicles.

A - Spencer Wang {BIO 3251222 <GO>}

Mike, I just --

A - Ted Sarandos {BIO 4812832 <GO>}

You should by the way -- you should think about particularly in the case of Stranger Things 3, you should think about all those product partnerships as a character in the film. We're running the show, remember the shows set in 1985 and it's set in the heart of when the big summer blockbuster movies were jammed with product placement and there was really a creative choice when they talked about pitching that season out it through to more than it was two years ago.

A - Reed Hastings {BIO 1971023 <GO>}

Mike, we have time for one last question, please.

Q - Michael C. Morris {BIO 2323139 <GO>}

Okay. Great. Usually, we like to do a big picture, but this is one very specific financial question what we get a lot and it's really about the margin potential of the business. Over time, I think it ties together a lot of these different things that we just talked about, but Spence we've had the chance to hear your opinion on a bit. I'd love to hear you expand on it. Because Netflix is a single revenue stream product, you're very clear in the letter that advertising is not part of your future despite what we read in the press. Can Netflix ever achieve the type of margins that we've seen historically out of cable networks speed and HBO, which is a unique single revenue model whether or another network fit that was a dual revenue stream or are we inherently going to be sub-historical average margins for Netflix on a global basis?

A - Spencer Wang {BIO 3251222 <GO>}

I mean you take it or Reed -- I can take it.

A - Reed Hastings {BIO 1971023 <GO>}

You got to do it.

A - Spencer Wang {BIO 3251222 <GO>}

Okay. Well, look, I think, we've demonstrated over the last few years that we're focused on building a very healthy long-term business model and growing those margins roughly 300 basis points for the last few years to a target of 13% this year, when we go forward -- when we look forward in terms of the margin potential and scale of the business, first, Reed talked about it a bit earlier our aspiration for business that's already 150 million paying members is to be a multiple of our current size.

So that is a network with a relative scale for premium entertainment network that really hasn't been seen before for those comparables that you mentioned in terms of those historical margins. So that works in our favor. And when we also think about the revenue per any individual subscriber and whether that's advantage with the dual revenue stream or single revenue streaming and our calculus now for building a global network is that we're best served to focus on that single revenue stream, winning those moments of truth with a great member experience and then continuing to price occasionally against that in a great value proposition when we start with great content, great experience and then offered at a reasonable price.

We think we can do that in a way that obviously continues to scale margins in a very healthy way, we're not going to provide specific guidance, but when you look at those comparables. There are some things that worked in our favor and some things that don't. So scale is in our favor. We think the subscription model is a terrific model for us. So certainly we believe that there is going to be more margin accretion over time and I'm kind of leave it at that. But you can assume that we have a long way to go.

A - Ted Sarandos {BIO 4812832 <GO>}

And, Michael, if you don't want to end on something that dry, I could say two things really quickly. One would be that to congratulate HBO on an incredible record-breaking year for Emmy nominations. They are -- continue to be the gold standard that we chase and we're really thrilled for them. And also, to the end of this month, on July 26, we're going to wrap up our 7th season -- 7th and final season of Orange Is the New Black and I wanted to thank Gigi Cohen for her incredible vision that helped really drive this whole idea of Internet television to new heights and the show wraps up in a really incredible emotional high, and we hope the fans love it.

Q - Michael C. Morris {BIO 2323139 <GO>}

Great. Thank you for livening that up, Ted.

A - Greg Peters {BIO 17539678 <GO>}

Thank you, Mike.

Q - Michael C. Morris {BIO 2323139 <GO>}

Thanks.