Q2 2021 Earnings Call

Company Participants

- Greg Peters, Chief Operating Officer and Chief Product Officer
- Reed Hastings, Founder and Co-Chief Executive Officer
- Spencer Neumann, Chief Financial Officer
- Spencer Wang, Vice President Invester Relation Corporate Development
- Ted Sarandos, Co-Chief Executive Officer and Chief Content Officer
- Unidentified Speaker

Other Participants

- Nidhi Gupta

Presentation

Spencer Wang {BIO 3251222 <GO>}

Good afternoon and welcome to the Netflix Q2 2021 Earnings Interview. I'm Spencer Wang VP of IR and Corporate Development. Joining me today are Co-CEO, Reed Hastings; co-CEO and Chief Content Officer Ted Sarandos; COO and Chief Product Officer Greg Peters; and CFO Spencer Neumann. Our interviewer this quarter is Nidhi Gupta from Fidelity. As a reminder, we'll be making forward-looking statements and actual results may vary.

Let's turn it over to Nidhi. Now for her first question.

Questions And Answers

A - Spencer Wang {BIO 3251222 <GO>}

(Question And Answer)

Q - Nidhi Gupta {BIO 15346079 <GO>}

Thank you, Spencer great to be with you all again this quarter. Lots of exciting stuff to talk about, so let's dive in. Just starting with the quarter, nice to see net adds coming in a little bit better than your expectations. Help us understand what contributed to that.

A - Spencer Wang {BIO 3251222 <GO>}

Sure Nidhi. I can take that and others can jump in, but as you saw the quarter kind of played out pretty much as expected. So, we deliver 1.5 million paid net adds relative to a guide of 1 million. And what we're seeing is what we've sort of been talking about for the last couple quarters and that there's still a bit of choppiness to our growth. We had the kind of big pull forward in 2020 of subscriber adds. We also had the push in production at some of our kind of key returning titles, big temple, new releases until the latter part of the year, but overall the businesses is performing well.

Our churn is actually down relative to the more comparable two year ago period in 2019, Q2 of '19 before COVID. Our viewing and I've talked about in the letter our engagement is up, nearly 20 % over that period. But we still feel a little bit of that drag in terms of our acquisition growth as we're pull -- as we're kind of working through. What we hope is we can't be sure, but what we hope is the tail end of this COVID choppiness where we see on the acquisition side as markets reopen, it does slow things down a little bit.

A - Unidentified Speaker

Yeah. And I'd just say that's a nice steady progression in terms of getting our COVID delayed slate back up to our foreign members. Little by little we're still very heavily back waited for this year. But there's a nice steady progress in the content -- in the quality of the content and the excitement around the programming that came out in this past quarter which we saw across the board in our films with Army of the Dead and Fatherhood and our series of both local language and English language for the world, like Lucon and Who Killed Sara and even our animated projects like Mitchells vs. The Machines was a nice hit this quarter. So we think nice steady progress, but reminder that we're still pretty back waited in that slate.

Q - Nidhi Gupta {BIO 15346079 <GO>}

What are you seeing in the business over the last month or so as some of your markets have really started to open up? What's kind of in your guidance for that and also the Olympics balance with the fact that you have a lot more content coming in second half?

A - Unidentified Speaker

Sure. Well, the Q3 guide is actually kind of reflects a lot of what we've seen in Q2 frankly. So, as I mentioned, the underlying business metrics are really healthy. The one thing we do see with COVID, is we don't see the big spikes that we saw in terms of engagement or acquisition or churn that we saw in the very early days of the pandemic. But on the margin, acquisition is impacted. So, for example, in Q2, when things tightened up a little bit, say in Brazil or India, we did see some increase in acquisition. And similarly as markets reopened particularly in most of EMEA and the UK and region that did have a bit of a headwind on acquisition.

And that's reflected basically in our Q3 guide as well. So similar business fundamentals, hopefully kind of starting to move a little bit further away from those market re-openings, which is why you do see some incremental growth, so better seasonal period as well as moving a bit away from those market re-openings, but not a big fundamental change and then hopefully into even more re-acceleration as we get to the end of the year, as we really get into the kind of heart of our of our -- kind of our kind of strong release schedule as well as peak seasonality.

Q - Nidhi Gupta {BIO 15346079 <GO>}

I think a big question on investors minds is just how do you feel about your ability to get back to pre-COVID levels of net adds as we get into 2022?

A - Unidentified Speaker

Yeah. Well, and others should chime in, but what's -- I just want to kind of emphasize even with the Q3 guide and then into Q4 when you -- if we deliver on our Q3 guide that we talk about in the letter that's -- that will be this the growth pattern in our business is over a long term is over the long trends is remarkably consistent and steady. So, we'll have if we deliver on our guide, it means we'll have added 54 million new members over that two-year period or on average 27 million a year, which is right in line with our past few years of growth in 2018 and '19.

So we remain on that growth trajectory. And again once we get into Q4 what we would expect is as we get through hopefully that tail end of the COVID choppiness we get into that strong strength of slate. We get to a kind of a high seasonal period for us. We'd expect to end the year on a much more kind of normalized growth trajectory. But, we kind of have to have to get there.

A - Reed Hastings {BIO 1971023 <GO>}

And maybe you can decompose the long-term risk in the two things, one is does Internet streaming slow down and that seems pretty unlikely. Internet streaming has been amazingly consistent, prolific as you get new competition in you get validation more reasons to get a smart TV or unlimited broadband. So I think for at least the next several years, the growth story of streaming as a whole is very intact. And then you've got the secular competition story does HBO or Disney or other entry have a differential impact compared to the past.

And we're not seeing that in the detail that we have for country, because they're launched in some countries and not in others, that gives us comfort. We're not seeing that in the total viewing like the Nielsen measures. And so we think mostly all of streaming is a growth story competing from linear TV. And that will be true say screaming as 50%, 60%, 70 % of dealing. And then there's going to be shake out and we want to be prepared and leading that. But again, the next up here screening is still in the early stages.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Thank you. That's super helpful Reed, that actually answered my next question. So, maybe just shifting gears to your longer-term outlook, there's been some focus in the market recently on additional sources of revenue that you might have in the future, but before we get to that help us understand what makes Netflix's core business a great investment for shareholders over the next five plus years? What's kind of the growth, the free cash flow, capital return algorithm that gets you excited that you think we should be focused on?

(Multiple speakers)

A - Unidentified Speaker

Well, I was going to throw it to one of you first if you like, so that's okay. You wanted to go.

A - Reed Hastings {BIO 1971023 <GO>}

The big picture that all investors get is being a secular Internet play and as much as Amazon was strong in 2005 and 2008 all of us collectively underestimated the impact of what the Internet could do. And this is the Internet applied to entertainment. And consumer entertainment around the world is an enormous market. It has great potential for us and potentially our competitors. And so that big thesis is again what gets people excited.

And when we're growing revenue by 19%, it's not that hard to grow greater basis points of margin. As the revenue growth slows, it'll get a little bit tougher, but we'll continue to lean into that. And so I would say it's fundamentally story of this big secular revenue growth, management team committed to growing profits and cash flows, and then returning those cash flows through buybacks which Spence got a big start on this quarter. So over to you Spence.

A - Spencer Wang {BIO 3251222 <GO>}

Yeah, I just -- you hit on all the key points. I would just add that, it's still early days in pretty much every market around the world. If we if you go overall and then you know we're roughly 20% penetrated in broadband homes and we talked in the last call that there's 800 million to 900 million either broadband or Pay TV households around the world outside of China. And as we continue to improve our service and the accessibility of our service, we don't see why we can't be in all or most of those homes over time if we're doing our job.

And then, if you look at the range from in APAC region where we're only roughly 10% penetrated so, clearly early days to arguably -- I guess more tenured markets at least like in UK where even there with some of the metrics we put in the earnings letter streaming and we'd alluded to this is only about 26% according to Nielsen of viewing consumption, so the 60% plus is still linear consumption. And then within streaming, we're only seven, we're only at 7% share of total TV. So we're only 7% of that 26%. So there's big tailwinds there, in terms of that overall trend from linear to streaming entertainment.

And then that plays out in the financials. So again, our profit margins over the last five years have grown 5x. Our absolute profit dollars have grown 20x as the business is scaled from about a $100 million to $2 billion of operating income per quarter over the past five years. And so that will continue to scale we think in a healthy way, because the nature of our business scales well, it's creating content from anywhere to everywhere in this very large addressable market with these big profit pools. So we think we have a long runway of growth profitability and return a value to shareholders.

A - Reed Hastings {BIO 1971023 <GO>}

And I think if you think about how slow the business fundamentally changes and how quickly streaming has changed the entire marketplace in terms of the way consumers watch, you go back to about only 8 to 10 years ago and no one was looking to the internet or to streaming for the highest quality content and today the most watched the most talked about, the most award-winning television is all coming out on streaming services. And to expenses point you've got this enormous addressable audience, we're only in a fraction of them and we're only getting a small percentage of their total viewing. So it's still, it's still an enormous prize and we're still in the best position to run after it as we've kind of expanded what Netflix is to members, which is not just a show you might like, but it's the shows you like, it's the film's you love.

(Multiple speakers)

A - Unidentified Speaker

-- letting us picture of this (inaudible)

Q - Nidhi Gupta {BIO 15346079 <GO>}

Great to get a little platform. No, I mean you make a good point. You created a consumer product with global appeal and as you said, if you do your job, there's no reason you shouldn't be in every Internet household overtime. At the same time, not all subs are created equal, and I think there's a lot of debate in the market as to, how long can you continue to grow revenue double-digit without some of these lower ARPU markets, really starting to kick in and in terms of kind of meaningful revenue contribution and even this quarter two-thirds of your net adds came from the Asia-Pac region. So, can you shut a little bit of light on that debate?

A - Unidentified Speaker

Greg, do you want to take it a little bit to in terms of just some of the growth in that those regions and our pricing?

A - Greg Peters {BIO 17539678 <GO>}

Yeah and I would say we're working hard to think about and how do we find this wide range of price points that speaks to a feature set and consumer needs in more affluent markets and we're really trying to find ways to add more value there while we are also thinking about the sort of populations that you're talking about and making sure that we're increasing the accessibility of the service and really the ability to participate in and drive joy from the stories that we're telling to more and more parts of the world's population that don't have as much means pay and of course the trick there is to find the right feature set offerings that allow us to sort of broaden that range without cannibalizing the other layers.

And where really take this sort of iterative approach, where we try different solutions to that sort of puzzle and then measure them based on this what's the net revenue that we're seeing. And so, very much what we're trying to do is as we bring in lower price plan offerings that sort of decrease average revenue per member we're also think about that from the calculus of expanding, the funnel in a way that delivers total net positive revenue. And we're definitely seeing that and the mobile plan launches that we did in 78 countries this quarter are an example of us trying to make incremental progress against that puzzle and broaden that reach.

Q - Nidhi Gupta {BIO 15346079 <GO>}

That's very helpful. How is competition, particularly as the competition consolidates affecting just you're thinking on longer-term pricing power around the world?

A - Greg Peters {BIO 17539678 <GO>}

I think ultimately, we are competing already with, tons of forms of places that consumers can spend their hard-earned money on entertainment. And mostly, what we're looking at is in the specific calculus of how do we deliver more value? How do we provide a wider range of incredible stories of high quality and diversity of content that appeals to those consumers and appeals to more and more consumers around the world. And if we do a good job there, then ultimately then we have the ability to go back and occasionally ask some of those members to pay a little bit more to keep that virtuous cycle going.

And so, I would say on the demand side, maybe, I'll let Ted speak to the supply side if he will in a second, but on the demand side, really it's just that sort of very narrow focus on are we doing a good job at adding value and continuing to deliver more to our members?

A - Ted Sarandos {BIO 4812832 <GO>}

Yeah, and I think in general, the dynamics of consolidation is you see it across all these companies basically had consolidated themselves into bundles on cable for years. And I do think all the access to these are all the same players we've been competing with from the beginning, just through different channels. So I think in general that doesn't change in terms of what the offering is. And in terms of access to that offering Netflix because of the size of our distribution platform and our ability to connect creators with a big audience, it's always been a big help in terms of lowering content to our platform.

A - Unidentified Speaker

And maybe certainly Disney buying Fox helped Disney become more of a general entertainment service rather than just a kids and family. Time Warner, Discovery if that goes through that help some but it's not as significant I would say, as Disney Fox. And then for the remaining three, how they combine or don't combine or cooperate, it's unclear. But again, day-to-day we just focus on the content choosing and conversation, how do we improve the service for our members? And like Greg said, there's so much competition from Instagram and TikTok and Sports and the Olympics and everything else, that back to the Nielsen data for the U.S. there's plenty of room to grow, without taking it away from the other streamers.

And I would look at all of these are when do those consolidations, when are they one and one equals three or one and one equals four versus which most of them tend to be which is one and one equals two.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Yeah, no that, that makes a lot of sense. Switching gears to you Spence, the last couple of quarters have shown us just how much profit potential is in this business. Going back to traditional TV networks the most profitable networks did 40% plus EBIT margins at peak and they didn't have the scale and direct-to-consumer business model that you have. So, what are kind of puts and takes as you look at your long-term margin potential against that 40% plus history that we've seen?

A - Spencer Wang {BIO 3251222 <GO>}

Well, I'm definitely not going to provide long-term guidance relative to the 40%, so well, I appreciate it, but it nice to know that those comparables are out there, those benchmarks are out there to have that ambition. But as we talked about before, what's what we love is that our business has a very scalable model. And so what's most important for us is to grow healthy and by that I mean, being able to aggressively strategically invest in the growth of our business while increasing our profit. And that's what talked about, before we have been doing pretty well so far so far and we'll continue to feel our way along.

So to date, we have been growing at three percentage points per year for over any few year period. And as Reed said, that's something that's been reasonably I wouldn't say easy, but accomplishable for sure when we're growing in that 20% or so revenue growth per year. Now obviously, that can't last forever in terms of three percentage points a year, but we think we have a long runway of growth.

We have some things that work to our advantage in terms of the global nature of our platform, the ability to create stories anywhere. And it's they travel well not just in their market, but across countries and markets around the world. So that's a nice model for us. We have a revenue model and subscription that also scales well in kind of established larger and smaller and emerging markets, and that's great as well.

And then, it's going to depend a bit on as the business evolves competitive dynamics, relative cost of content, of course, those things on the margin impact margin, but a lot of healthy growth ahead of us.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Reed the 300 basis points of margin per year has been spilled, good amount of discipline on the business, probably rained in Ted's content budget a little bit on the margin. But why is that sort of the right cadence, going forward and I know what's an average. But if we look back in five years and, the average was lower than that would it have been, because of new businesses, you found to invest in or competitive forces or something else?

And Reed, the 300 basis points of margin per year has instilled a good amount of discipline on the business, probably reined in Ted's content budget a little bit on the margin. But why is that sort of the right cadence going forward? And I know what's an average. But if we look back in five years and the average was lower than that, would it have been because of new businesses you vow to invest in or competitive forces or something else?

A - Reed Hastings {BIO 1971023 <GO>}

I don't think there was a ton of magic in the 300 basis points. If we had decided on 200 or 400, we'd be marginally different today. But I think, in the long term, we get to the same place. So it's a guess that sets up our framework for how we think about the allocation into faster growth that Ted and Greg have been driving, and providing profit stream for our investors. So we're comfortable on that balance and the big prize is keeping the revenue growth at 20%. So most of our time is like, okay, how do we get the revenue growth going, how do we have the content that's you just can't ignore everybody's talking about, and that's what fuels those big surges. And the more we do, the more we're learning. So we're making a ton of progress, show by show, film by film of how to really push the consumer satisfaction. So that's very promising. That's work that you'll see showing up next year and beyond.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Great. Reed, maybe just staying on you for a minute. On the last earnings call, you talked about video streaming being sort of the main profit pool, and over time, potentially, smaller supporting profit pools. Over the last few months, you've made some key hires in the gaming and podcasting, you've launched an online store, I believe you've expanded your deal with Shonda Rhimes to include live entertainment. Can you just talk us through which of these sort of adjacent business areas actually has the potential to be a meaningful profit pool in the future?

A - Reed Hastings {BIO 1971023 <GO>}

Well, I would say none of them that is that they're not designed to be, because -- but I'll draw to a distinction. There's things that our consumers love it in our service. So Shonda Rhimes future work we're very confident of. Video gaming, we're pushing on that and that will be part of our service. So unscripted, all those things. So think of that as making the core service better. So lots of investment, but not a separate profit pool, it's enhancing the big service that we have.

And then there's a number of supporting elements, consumer products, various shopping. We're really trying to grow those to support the title brands to get our conversations up around each of the titles so that the Netflix service becomes must-have. So they're not a profit pool of any material size on their own, but they are helping. The reason we're doing them is to help the subscription service grow and be more important in people's lives. So I would say, really we're a one product company with a bunch of supporting elements that help that product, meaning incredible satisfaction for consumers and a monetizing engine for investors.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Great. That's helpful. Just to follow up on gaming. Greg, I'll take it to you, very exciting to see a key hire in gaming. Last week, there were some more detail in the shareholder letter as well. But just bigger picture, how will you achieve the things that matter most to gamers, whether it's great content, ease of play, a network of gamers to play with? What are sort of the unique assets that Netflix brings to the table? And why will people be excited to play games on Netflix?

A - Greg Peters {BIO 17539678 <GO>}

Yes. Well, sort of picking it up where Reed left off, we really see this as an extension of the core entertainment offering that we've been focused on for the last 20 years, right? So just as we've continuously expanded the nature of our offering by adding new genres, unscripted film, local language programming, animation, on and on, we think we have an opportunity to add games to that offering and deliver more entertainment value to our members through that. And similar to what you've seen in that trajectory when we've added a new genre, that's what we expect will happen with games. So this is going to be -- it's a multi-year effort. We're going to start relatively small. We'll learn. We'll grow. We refocus our investment based on what we see is working. We'll just continuously improve based on what our members are telling us is working.

But I'm really excited about a bunch of different ways that I think that we can provide an offering here that is differentiated from what's out there already. And the first of those is really about the IP that we create. We are in the business of making these amazing worlds and great storylines and incredible characters, and we know the fans of those stories want to go deeper, they want to engage further. They actually want to direct a little bit where their energy goes. And what's great about interactive is, first of all, you can provide universes that just provide really significant amount of time that people can engage in and explore. They can also provide a little bit of intentionality, where do they want to explore, what characters, what parts of the world, what parts of the timelines. There's just a lot of exciting things that I think we can do in that space.

And we also feel that our subscription model yields some opportunities to focus on a set of game experiences that are currently underserved by that sort of dominant monetization models and games. We don't have to think about ads. We don't have to think about in-game purchases or other monetization. We don't have to think about per title purchases. Really, we can do what we've been doing on the movie and series side, which is just hyper laser focused on delivering the most entertaining game experiences that we can. So we're finding that many game developers really like that concept and that focus and this idea of being able to put all of their creative energy into just great gameplay and not having to worry about those other considerations that they have typically had to trade off with just making compelling games. So those are some of the core things that we're excited about and think that can make this effort for us special even in the world of games.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Thank you. That's super-helpful. I've always known this management team to take an incrementalist approach on these things, while also having a well-informed thesis on the long-term and how things will play out. So if you can articulate it, what is sort of your long-term thesis on gaming? And as starting with mobile and sort of a content vertical strategy, is that sort of a starting point or is that an ending point? I mean, do you see yourself as a platform over time? Do you see gamers coming to the TV to play? What is sort of the long-term thesis of what this could evolve into?

A - Greg Peters {BIO 17539678 <GO>}

Yes. And I'll just -- I'll take it from the platform angle first and sort of make -- maybe widen that view. But we think mobile is a great platform for games. Clearly, it's very mature, it's got great enabling technology tools, a great developer community and the vast majority of our members have phones that are capable of great gameplay experiences. So it sort of checks all of those boxes. And so, it'll be a primary focus for us to deliver those experiences. But ultimately, we see all of the devices that we currently serve as candidates for some kind of game experience. We've actually been delivering lighter-weight interactive experiences on TVs and TV connected devices for some time, and you can call those games, you can call them interactive experiences, but obviously, they all exist on a spectrum. And we're going to keep innovating in that space, and we feel like there's a rich opportunity to continue to deliver and advanced the technical capability to improve the quality of game experiences we can deliver across the range of devices.

And then, we want to -- we'll be very sort of experimental and try a lot of things in this phase [ph]. A lot of what we have to do right now is just focus on learning -- and you mentioned that sort of incrementalist approach. A lot of this is really trying to maximize learning velocity is what we would say. So we're going to try a bunch of different games through a variety of different mechanisms to see what's really working for our members, a part of that will be games that extend our IP, we think that's a really rich, rich space. So that's very much part of our long-term thesis. But also, we'll do things where we try standalone games. Like, ultimately, the success of this initiative is about great games fundamentally and those can come from a variety of different sources. Maybe someday we'll see a game that spawns a film or series that would be an amazing place to get to and really see the rich interplay between these sort of different forms of entertainment.

We'll also do licensing, because we -- just so we've done in that sort of other genre expansion, it's a great way to increase the volume of the offering that we have at the start to learn more quickly, and then as our internal production sort of scales, we can focus the energy on what we're learning in that regard. So broadly, we think, as you said, there's a big, big prize here and our job is really to sort of be very focused and deliberate about what we're going after that maximizes the learning value, iterate that continuous improvement approach and we feel that that's yielded really big results for us as we followed that sort of technique and all the kind of genre expansions we've done around the service.

Q - Nidhi Gupta {BIO 15346079 <GO>}

And is the financial success of this over time, should we think about that as higher ARPU for the Netflix service? Or is there a standalone sort of financial success here you think over a very long period of time if you're successful?

A - Greg Peters {BIO 17539678 <GO>}

I'm not going to guess it to very, very long-term, but we're really thinking about this as a core part of our subscription offering, and so we'd measure it very much like we do around the success of adding incremental movies or adding incremental series, which is that ultimately those are about like being compelling to members having them engage and talk about it having that be part of the social conversation that's out there. We see those benefits in retention, obviously, for delivering more value there than members stay with us longer. We see those values in acquisition as well because when there's a -- if there's a great game that lots of people are talking about to their friends, their colleagues, their family, then that's a source of acquisition for us as well.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Great. Thank you. That's super-helpful. Maybe switching gears to another content vertical, sports, which comes up a lot. Ted, you haven't historically been keen on buying sports rights and that may have been the right call given the cost escalation we've seen there. But you have had a lot of success with sports-related programming, like the Michael Jordan documentary, the F1 series. Do you see Netflix becoming sort of a key destination for sports-related content over time (inaudible) you've been thinking news and analysis or sort of a limit to what you can do without the underlying rights?

A - Ted Sarandos {BIO 4812832 <GO>}

Look, I think we've -- you pointed it out, but our success with the sports adjacent properties, like the F1: Drive to Survive, Deaf U, and certainly the Michael Jordan doc, those are all examples I think of the platform and what it can do to build enthusiasm on what is already viewed to be an enormous business. Drive to Survive expanded the audience for Formula 1 racing pretty dramatically, both in live ticket sales and TV ratings and merchandise sales, all those things. And I think that that can be applied as long as the storytelling is great. So what's good about this for us is that we could apply those same kind of creative excellence to the storytelling behind those sports, the personalities behind those sports, the drama that happens off camera. And fans, not only deep fans are compelled to see more, but also can bring new folks into the sport.

So we think it's pretty exciting. We think it's a -- we'll continue to explore it. We have this incredible documentary on Naomi Osaka that's just came out this week, that's another example of this that can really broaden the fandom for the tennis world, particularly going into this exciting period of the Olympics.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Outside of the big American sports football and basketball, we have already seen a lot of the cost escalation. Are there more niche sports or sports in international markets where you feel like there might actually be a good ROI on owning the live air rights?

A - Ted Sarandos {BIO 4812832 <GO>}

Look, I don't know that those sports suffer from being under-distributed, so I don't know that we would bring that much to them. And just to be clear, we reiterated this a lot, but I'm not saying, well, it's a never say never on sports, it's just what is the best use of about $10 billion. And I think that's what it's going to cost to invest meaningfully in big league sports, and that pricing is only gone up since I started saying that. So I believe that that's likely to hold. But again, I don't think it's because those other sports are niche because they're under-distributed and that we could bring a lot to them. Our fundamental product is on-demand and advertising free, and sports tends to be live and packed with advertising. So there's not a lot of natural synergies in that way, except for it happens on television. So when it becomes the best use of that next tranche of investment, we definitely would be open to it.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Do you see any merit in what Amazon is doing in sports?

A - Ted Sarandos {BIO 4812832 <GO>}

I don't know, no particularly what they're doing -- I mean, I know what they're (inaudible) I know what they're doing, but I don't -- I'm not sure exactly what, they're looking for the same thing from their content spend that we are.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Yes, that's helpful. Reed, switching gears to you. You wrote in your book about farming for dissent inside the organization on strategic decisions, which I thought was a really interesting chapter of the book. What would you say are some of the biggest debates inside Netflix today as it relates to strategy?

A - Reed Hastings {BIO 1971023 <GO>}

I'm a little careful on that relative to competition because most of them about how do we help [ph] Fox-Disney, so to speak, and deliver amazing entertainment. So that would be the (inaudible). But if we do it in hindsight, we talked about video games for several years, writing up the pros and cons of the timing of entry. That has properties like film that you can own the IP, you can have these long franchises and very positive for us and kind of industry structure wise if we can master the skill set. And so really, it came down to us thinking that the incremental money to fund games made sense relative to our other content investments. So that would be the kind of process that we go through.

A - Ted Sarandos {BIO 4812832 <GO>}

I think at a healthy way to look at it, Reed, might be, in hindsight, almost everything that we've done, which has turned out well, also came with a very hearty debate period with people with very good opposing positions on why we should or shouldn't do it. And I'd say, that's been true of every expansion we've taken on

A - Spencer Wang {BIO 3251222 <GO>}

Nidhi, we have time for two last questions, please.

Q - Nidhi Gupta {BIO 15346079 <GO>}

Great. Spence, I'll turn it to capital allocation. It's very exciting that we're on the cusp of achieving positive free cash flow. So a couple questions on that. First, what's the rationale for keeping debt -- gross debt at sort of $10 billion to $15 billion range while free cash flow grows over the next few years?

A - Spencer Neumann {BIO 3006410 <GO>}

Yes, there's -- similar to our -- I guess, our profit margin growth, there's not like a pure science to it, but what we viewed it as is, we want to maintain some level of leverage in the marketplace because we want the familiarity -- excuse me -- with the capital markets should we need access to capital over time. So that's why we talk about that that $10 billion to $15 billion of leverage. But again, there's not a perfect science. So what's most important to us in terms of our capital allocation strategy again is to invest strategically in the business. So that is our first priority, that's what hopefully you're hearing in terms of our investment into film, into television, extension into video games and hopefully other content categories, over time, in that kind of mission or objective to entertain the world.

But as we have excess cash, we will return it to shareholders occasionally, that's why we started the share repurchase program. We repurchased $0.5 billion of shares in this last quarter in Q2. It's not -- there's a fixed amount that we're going to repurchase every quarter, that's really after we've satisfied all of those other strategic objectives. And then we'll kind of take it from there, but we have $5 billion share repurchase authorization. We will maintain some debt in the capital markets, but we've significantly delevered. I think, our leverage is down to about 2.5x debt to EBITDA, which was above 5x not too long ago. And we think it's important to have the flexibility in our balance sheet to invest into growth while being kind of prudent and responsible with our capital allocation. I don't know, Spencer, maybe you would add to it, but we talk a lot about this topic.

A - Spencer Wang {BIO 3251222 <GO>}

No, I think you nailed it, Spence.

Q - Nidhi Gupta {BIO 15346079 <GO>}

And just related to that, I mean, your appetite for M&A has historically been pretty low. I'm wondering if that changes it all as you explore gaming or perhaps other areas. In your core business, you haven't seemed as interested in some of the traditional assets that have been in the market, like MGM for example. What are the characteristics that make a good acquisition for you?

A - Spencer Neumann {BIO 3006410 <GO>}

Well, Spencer runs that group for us, so I'll let Spencer answer and I can chime in.

A - Spencer Wang {BIO 3251222 <GO>}

Thanks, Spence. And Nidhi, it's a good question. So I guess a couple things without speaking towards any specific opportunities. I would say, as a company, we look at many different ways to help accelerate the growth in our business, including M&A. So you should assume we look at many, many different things. And we've said in the past that we're open to content assets that can help accelerate our growth, things like intellectual property that we can develop into the original series and movies, in addition film and TV libraries could be interesting as well we'll see on the gaming side.

That being said, we are mindful of a couple things. First of all, our encumbrances, for example, which -- if some of these content assets are heavily encumbered and limit our ability to use them on Netflix, then they are of limited value to us, since our top priority is to grow the core Netflix business. Secondly, our opportunity costs and trade-offs. So as we evaluate M&A, we always think about if we bought company X or asset X for Y dollars, what's the alternative use of Y dollars and which is best for the company. So hopefully, that gives you a little bit of a framework for how we think about M&A

A - Spencer Neumann {BIO 3006410 <GO>}

Yes, the key it is, it has to accelerate our strategy at low -- with low distraction cost and so we're pretty picky.

A - Ted Sarandos {BIO 4812832 <GO>}

It's got to be something that's in the smack, right in the middle of the strategic core of what we're doing.

Q - Nidhi Gupta {BIO 15346079 <GO>}

I mean, I guess with that backdrop, I mean, is there any reason to think the majority of free cash flow wouldn't be used for buybacks in the future?

A - Spencer Neumann {BIO 3006410 <GO>}

Well, we're getting ahead of ourselves a little bit but it's certainly something we've contemplated as why we have the $5 billion authorization. But that'll be -- I kind of look at that as a high-class problem where we've guided to cash flow roughly break even for this year. So let's get through this year and kind of look at how we're tracking next year. I'm excited for getting hopefully passed this nearly -- well, then be almost a two-year global pandemic and a really kind of full content slate and hopefully a more normalized world and then we can worry about what to do with our excess cash.

Q - Nidhi Gupta {BIO 15346079 <GO>}

It's good problem to have.

A - Ted Sarandos {BIO 4812832 <GO>}

There you go [ph]. Well, thank -- Nidhi, thank you so much for doing this again with us. I just want to say, we're really happy with the quarter, we're happy with the programming, we're happy in this very complicated time, both in the world and the business to be growing subscribers and revenue. This is a big story, mostly about how the world is in love with streaming.

And when it comes to watching your favorite show, your favorite film, it's more likely to be happening on streaming than ever before, and it's still just scratching the surface as to the potential for the business. And while everybody else is trying to figure out how to unwind businesses and restructure businesses and put together enormous populations of employees, we're focused on three things. I know we're spending about a thousand plates, but we're really focused on our three things, which is our content, our choosing, and driving conversation around the world. And with that, we're really confident in our team to continue to drive that and drive us to continued success. So thank you.