S&P Global
Market Intelligence

Netflix, Inc. NasdaqGS:NFLX

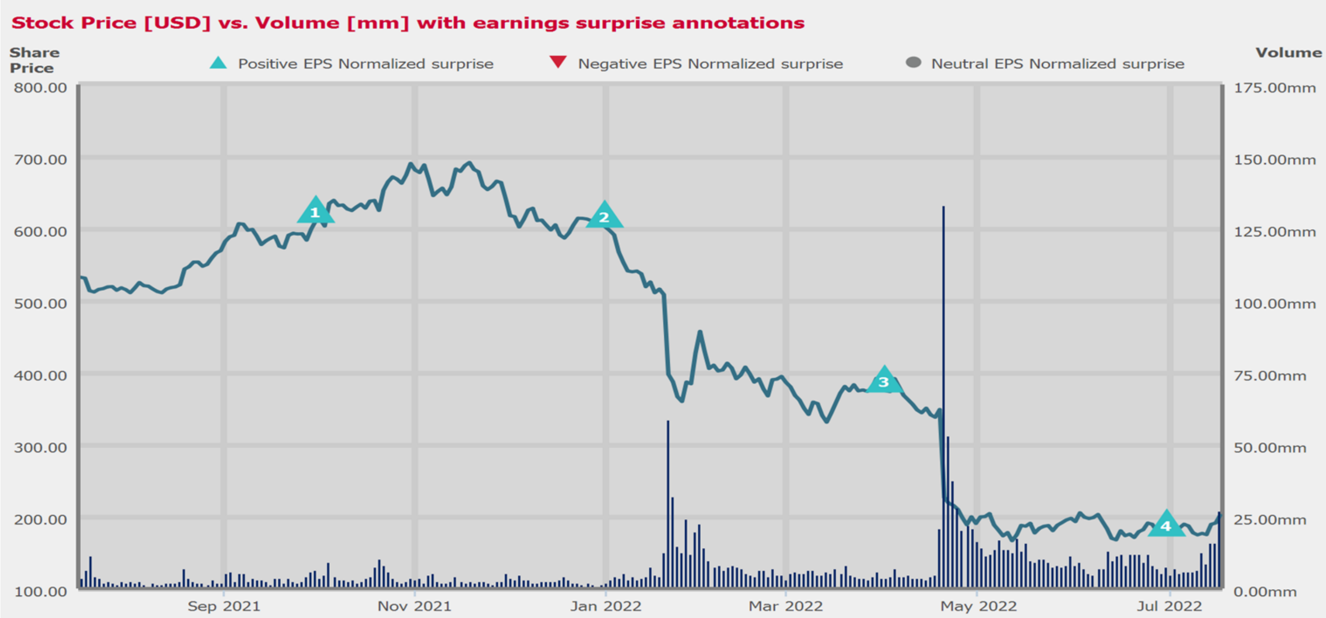
FQ2 2022 Earnings Call Transcripts

Tuesday, July 19, 2022 10:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-		-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	GUIDANCE	CONSENSUS	CONSENSUS
EPS Normalized	2.95	3.20	▲8.47	2.76	2.14	10.77	11.99
Revenue (mm)	8034.57	7970.14	▼(0.80 %)	8099.01	7838.00	32246.81	35227.31

Currency: USD
Consensus as of Jul-19-2022 12:47 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2021	2.56	3.19	▲24.61 %
FQ4 2021	0.82	1.33	▲62.20 %
FQ1 2022	2.92	3.53	▲20.89 %
FQ2 2022	2.95	3.20	▲8.47 %

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Call Participants

EXECUTIVES

Gregory K. Peters
COO & Chief Product Officer

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Spencer Adam Neumann
Chief Financial Officer

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

ANALYSTS

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Presentation

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Good afternoon, and welcome to the Netflix Q2 2022 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, Spence Neumann. Our interviewer this quarter is Doug Anmuth from JPMorgan.
As a reminder, we'll be making forward-looking statements, and actual results may vary. With that, I'll turn it over to Doug now for his first question.

Question and Answer

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Great. Thanks, Spencer. Great to see all of you, and thanks for having me host again today. So there's clearly a lot to talk about on advertising and new initiatives, but let's start with talking about recent trends. So you expected to lose about 2 million subscribers in the quarter, and you did a little bit better at a loss of 970,000. What drove the slightly better-than-expected results in the quarter?

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

Looking at the quarter, Doug, we're executing really well on the content side. Obviously, Ozark, Stranger Things, lots of titles, lots of viewing. We're improving the -- everything we do around marketing, improving the service, the merchandising, and all of that solely pays off. If there was a single thing, we might say Stranger Things. But again, we're talking about losing 1 million instead of losing 2 million. So our excitement is tempered by the less bad results.

But looking forward, streaming is working everywhere. Everyone is pouring in. It's definitely the end of linear TV over the next 5, 10 years. So very bullish on streaming. And then our core drivers are just continuing to improve. And then, of course, we'll talk later in the call about monetization and how that's improving. So tough, in some ways, losing 1 million and calling it success. But really, we're set up very well for the next year.

Spencer Adam Neumann
Chief Financial Officer

And Doug, I'd just add to that. I mean the business stays -- remains really resilient. And basically what you see in the quarter is it played out generally as expected, as Reed said. So the minus 1 million versus minus 2 million is slightly better in terms of member growth, and then on revenue, operating income, cash flow. Other than the strengthening U.S. dollar, which I'm sure we'll talk about it affects multinationals around the world, our revenue was in line with guidance. If you adjust for that in our restructuring costs, our operating income was above guidance. Our EPS was above guidance and our cash flow remains strong. So overall, generally delivering as expected.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

So almost all of the subscriber base has seen a pricing change over the past year. How do you think about that in terms of a factor just perhaps in 2Q and maybe even going forward just in terms of gross adds or churn? I think you still have perhaps some rollout in U.K. and Ireland and maybe the tail perhaps in 2Q in the U.S.

Gregory K. Peters
COO & Chief Product Officer

That's right.

Spencer Adam Neumann
Chief Financial Officer

Go ahead. Go ahead, Greg, and then I'll...

Gregory K. Peters
COO & Chief Product Officer

Okay. Yes, I'll kick it off, and then you can take, Spence. But I would say most of what we've seen in the countries that you mentioned, the big ones that we've done so far this year, U.S., U.K., Ireland, we've seen pretty much the standard response that we've seen historically over the last 5 years or so, which is we typically have this adjustment period where there's slightly higher churn post the price change. And that's certainly what we've seen in those countries.

But then if we do a good job basically at taking those price changes, which are significantly net revenue positive and investing those into more great content and the product experiences and marketing and magnifying the conversation around our titles, then we know that we'll deliver more entertainment value when we'll be able to return those metrics. And that's certainly what we are seeing in the United States, for example, where we're seeing those like the churn, for example, that you mentioned, return to pre-price change levels. So largely, that performance is as we've seen historically and what we would expect.

Spencer Adam Neumann
Chief Financial Officer

So Greg, you hit on it at the end in terms of the -- it's part of what you see in the Q2 performance and the Q3 guide is that we're getting further away from some of those price changes. We always expect to see some slight elevated churn after price increases, as Greg said, highly kind of revenue positive. And so we had some elevated churn early in the quarter because we had some big price changes, big markets that had price increases like U.S., U.K., Ireland, some other parts of EMEA, early in both Q1 and rolling through Q2. But then as we get further past that, that's part of why you see positive paid net-adds guidance in Q3.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. So when you think about the back half, and Spence, you just mentioned some of them, but some of these factors seemingly improve just as you get perhaps greater distance from some of the pandemic pull forward. You mentioned greater distance from pricing, better seasonality, I think the content slate builds through the year. I guess the question is, why only 1 million net adds in 3Q? And how do you think about subscriber growth for the back half overall and for the entire year?

Spencer Adam Neumann
Chief Financial Officer

Well, you kind of hit out, and we talked about some of the things that were near-term kind of headwinds to the -- at least the subscriber growth numbers as well as revenue growth in our business, whether it's the combination of growth in connected TV homes around the world, it's that. It's a little bit of paid sharing. It's competition and some of these macroeconomic factors like higher inflation as well as the invasion of the Ukraine and the knock-on effects around EMEA and other parts of the world. So we're still kind of working through that.

But exactly as you say, we get further away from price increases, we get to a stronger seasonal period, we get to strength of slate, and we're working to address all these things. Some of them take a little bit more time to address, like what we talked about with paid sharing, which we'd talked about in the letter. And I'm sure you'll get to that, but some of these we actually have to take action to further address.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. The business was very different, clearly, in 2008 and 2009. But in a recession and just tougher macro in general, how do you think Netflix and streaming, more broadly, would hold up?

Spencer Adam Neumann
Chief Financial Officer

Do you want me to take it or do you want somebody else?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Just to add real quick. I think it's really important that particularly in tough economic times that consumers see Netflix has a tremendous value. So adding great content that they love and they can't -- that they can't wait for the new season, to add tremendous value in the form of -- this Friday, what do you see this movie, Gray Man, that's going to be premiering on Netflix. This is an enormous big budget action film that normally people would have to go out and spend an enormous amount of money to take -- to go see.

And they're going to -- premiering it on Netflix. And then we've got a steady drumbeat from movies like Me Time with Kevin Hart and Mark Wahlberg coming up; and a new addition of 365, Next 365 Days, a big franchise; a new season of Cobra Kai. Obviously, we saw the impact from Stranger Things this quarter, but that's just like the tip of the iceberg for the value that we're bringing to the consumer, and I think the consumer will embrace that even more so in tougher economic times.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. Great.

Gregory K. Peters
COO & Chief Product Officer

I'd extend that just a touch. I mean we think Netflix is a great entertainment value. We want to keep and make sure that it is a great entertainment value. We try to provide a range of price points to consumers around the world to make sure that, that service is accessible even in the current environment. And I would say, I'm sure we'll get to this in a little bit, but I think that our ad-supported offering is an extension of that sort of pro consumer, wide range of prices that will increase accessibility of the service, especially in the years to come.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

And just to build on, lastly, just the risk of -- Spencer, go ahead. You'll hit on it. Go for it.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Sorry, Doug, I was just going to add, if you zoom out a bit and look at past economic cycles, at least in the U.S. most forms of entertainment have been fairly resilient to downturns. There's a level of escapism, I think, that entertainment provides. Also, if you look at the Pay TV business over economic cycle, it tends to be a bit more resilient as well, just because the value of in-home entertainment increases as folks perhaps don't go out as much.

And also as a subscription business, it tends to be a little bit stickier. I don't -- obviously, every recession and cycle is different. So we don't want to take that for granted, and we're monitoring pretty closely, but that's hopefully a little bit of helpful context for you.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

That's helpful. So let's shift gears, talk about advertising, clearly on everybody's minds. Reed, you've talked about making the Netflix ads a better ad experience than what's available on TV today. Can you give us an update on what the product will look like, some early thoughts there? And then also about -- more around timing, which I think you said early 2023.

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

That's a great question for Greg here.

Gregory K. Peters
COO & Chief Product Officer

Yes. I think we're looking at this as an extension of 2 things that we think that we've historically done, which is, one, to be very consumer-centric and think about the customer experience. And then also just taking an innovation-oriented view, whether it's sort of how we started in streaming to how we think about great quality of experience and the innovations we've led and I think in the discovery and choosing side. So we think that we have a real opportunity here to -- through a period of years and iteratively. So I want to set expectations at the onset.

We're going to take an iterative approach. This is what we call the Crawl, Walk, Run model. So at the beginning, it will look what you're familiar with. But over time, we think there's a tremendous opportunity to leverage that innovation DNA that we have as well as a bunch of sort of enabling characteristics around addressability and measurability and things like that to, one, provide an incredible experience for consumers, those who choose to take the ad-supported offering, but also provide an incredible experience for brands and advertisers who want to work with us to make sure that we're doing a good job of elevating what that looks like for them.

So there's a bunch of lines, of inquiry lines, of innovation that we're going after that sort of support all of that piece, and I think we'll get into that iteratively as we go. But I think when you look at the scale of our offering, the technical DNA we have, the partners that we've got lined up, I'm pretty optimistic that over a couple of years, we can deliver an experience which is fundamentally different from the ad experience on linear in a way that supports all of the stakeholders.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

And Greg, when you say the partners that you have lined up, I mean, Microsoft, obviously a key one. Are you referring to advertisers here as well? They're already taking a lot of interest. Maybe you could talk more about what that looks like at this early stage.

Gregory K. Peters
COO & Chief Product Officer

Yes. We've seen a lot of excitement in our early discussions with brands holding agency -- holding companies and the agencies because I think for them, it's been -- they've wanted to connect with the titles, incredible content that Ted's team was putting out there. And I think we also share a perspective on what is a great experience for consumers and for advertisers. So when you think about the kind of advertising we see, frequency caps, what's a great ad experience, we're noticing a high degree of alignment there. So that enthusiasm, that alignment is increasing sort of my optimism and the excitement that I've got to basically get this out there because I think it's going to be a win-win-win for all parties involved.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

So will -- in terms of the Microsoft deal, will ads be sold early on exclusively by Microsoft? And how do you think about your desire to build out more of your own sales force over time?

Gregory K. Peters
COO & Chief Product Officer

Yes. So all of the ads that are served on our ad-supported offering will come through Microsoft. So that's an exclusive arrangement with them. But one of the reasons that we're partnering with Microsoft, there's a bunch of fundamentals. They've got a technical capacity, which is complementary to ours a go-to-market capacity, which we need to leverage, and it will be very important for us.

But a key component of what we liked about this partnership was that there was sort of a flexibility in that innovation orientation that I mentioned before. And so they very much, I think, are approaching this as an opportunity to work together to collaborate and to sort of evolve both the technical capacity and also sort of what the experience is and what the go-to-market approach is. So we've got lots of flexibility to work together there and evolve that over time.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. You already have tiers across a range of prices. But what do you anticipate will happen in terms of members switching plans and perhaps trading down to the ad-supported tier? And do you have a view kind of long term what percentage of subscribers might be on the ad-supported tier?

Gregory K. Peters
COO & Chief Product Officer

Yes. I would say, in general, we know that there's price sensitivity around consumers. And that -- some of those consumers are folks that have never actually ever signed up for Netflix. Some of them are folks that were members for us for a period of time and they decided to cancel for a variety of reasons. Some of those are folks that are currently watching Netflix, but they're using another paying member's account credentials, right? So those all, I think, represent opportunities for us because we're bringing a wider range of prices through the ad-supported offering, a lower consumer-facing price to be able to attract a broader set of members. So that's sort of very consistent with our wide range of pricing and our general goals there. We think that's great for consumers. It's good for us, obviously.

And when we run the models and talking to brands, advertisers to Microsoft, we look at the monetization that is the complement to that sort of subscription part of the ad-supported offering, and we're quite optimistic that the sort of unit economics work to make that monetization sort of equal or maybe even better than what we would see on the comparable side for the non-ad, subscription-only kind of plans. So we think that this is, again, expansive from a member reach perspective but also neutral to positive on the unit economics and monetization. So that's great for us for -- obviously from a business perspective.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

And should we be thinking about this as a single tier essentially below the basic plan?

Gregory K. Peters
COO & Chief Product Officer

I would say, over a period of time, we think that this is sort of one of the dimensions that will inform sort of our plan structure. And I would say, generally, our thinking of going from our Good, Better, Best model that has been sort of the core offering that we've had into making that slightly more complicated because we're going to have more sort of discrimination features that would inform what offering consumers ultimately choose to get to. So there'll be a little bit more complexity there in ads. No ads will be one of those dimensions. But we want to work into that model. And obviously, while we're thinking about the right pricing model there, we also want to keep it as simple as we can from a consumer-facing perspective. So in terms of the on-ramp, the planned selection, how upsells happen, we want to sort of work those flows iteratively over time, so we build into that complexity without making overwhelming for consumers.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Sure. Okay. And you talked about advertising monetization, essentially helping close the gap perhaps with current ARM or getting above that level. How long -- how do you think about timing? And perhaps how long it could take to get to kind of current ARM levels on the ad tier?

Gregory K. Peters
COO & Chief Product Officer

I think about the timing more as sort of how we roll this out and how we sort of build more subscribers on those ad-supported offerings. So a component of this is countries. So obviously, we're launching first in the countries that have sort of the more mature ad markets and we feel more confident in the ad monetization, then we'll sort of explore next tiers of countries over time. So that's a dimension of growth.

But I would say the initial response that we're getting from a brand and an advertiser perspective is quite strong. So we feel quite confident that as we sort of grow into this and we have more subscribers over time on these plans, that at least initially the unit economics are going to be -- are quite good. So we don't sort of see this as sort of building in that, call it, CPM side so much more is that we're actually building the total amount of volume on those plans and then the total amount of revenue. And again, this is going to start small relative to our total revenue mix, but we think we can grow it to be substantial over a period of time.

Spencer Adam Neumann
Chief Financial Officer

I think that's key, Doug, is that this is going to build over time. It's not like all of a sudden, all folks on ad-free Netflix are going to join advertising Netflix. And so supply/demand, I think, probably works in our favor between both geography as well as opening up the aperture to our members.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. You talked in the letter certainly about the ad product is having the potential and likelihood to drive overall member growth and then certainly overall profitability. But Spence, maybe you could talk a little bit about what it means for margins and some of the puts and takes there versus the current business.

Spencer Adam Neumann
Chief Financial Officer

I'd say, overall, Doug, these are -- this is -- our focus is as we've talked about these initiatives across paid sharing as well as advertising as ways to better monetize our viewing and grow members, as Greg said, advertising, as an example, it can do both. And we believe we can do this both in a revenue-accretive way as well as a profit-accretive way.

As we roll out a solution for paid sharing, that probably has a more near-term impact once we get to a solution that works, and there's not a lot of incremental expense to that. And then on the advertising side, we have some -- obviously some incremental costs that go against that business. But as Greg said, there's incremental revenue, we believe, at the unit economic level, so we think we can manage that pretty -- to a -- an operating income neutral to positive pretty soon out of the gate. So -- but it's a slower build over multiple years to have a material impact on the business. But our focus across 2023 and '24 is to build out to kind of return to a more accelerated revenue trajectory for the business.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. Along those lines, there's been a lot of discussion around -- that Netflix needs to renegotiate deals perhaps with content providers to monetize through advertising. But also a lot of your viewing clearly comes through original content. Maybe you can help us understand what needs to be done on the licensing side and how to think about some of those incremental costs.

Spencer Adam Neumann
Chief Financial Officer

Ted, do you want to jump in?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. Today, the vast majority of what people watch on Netflix, we can include in the ad-supported tier today. So there are some things that don't that we're in conversation with the studios on. But if we launch the product today, the members in the ad, too, would have a great experience. And we will clear some additional content, but certainly not all of it. If we -- so we're looking -- but I don't think it's a material holdback to the business.

Spencer Adam Neumann
Chief Financial Officer

It's certainly a nice to have, Doug, but it's not a must-have. As Ted says, we can launch today without any additional content clearance rights. And hopefully, we can supplement that, but we'll be disciplined in what we do.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Got it. Okay. Why did you choose Microsoft over other potential ad partners?

Gregory K. Peters
COO & Chief Product Officer

Some basic levels, they've got the technical components we need. They've got the go-to market components we need. They made a bunch of sort of fundamental, what I would characterize as, table stakes pieces, which is a strong commitment to privacy, data protection, things that we cared a lot about and were fundamental to us.

But I would say at the -- beyond those things, it was really what I mentioned before, which is that we saw a high degree of strategic alignment in their interest in innovating in the space and really working with us over the next several years. to basically try and create a new ads ecosystem around premium TV, connected TV ads. And so both from the consumer perspective because that's really important, and I think we've seen the sort of long arc of advertising towards very pro-consumer, let's make advertising part of the quality of the experience rather than detracting from it as well as having a really strong brand and advertiser kind of focus on what do they need to support their goals from there. And so we saw that as being a lot of alignment out of that, and we're just excited to sort of work with them iteratively on making that happen.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

And is it fair to think that there are some significant guaranteed revenue commitments here over the next few years?

Gregory K. Peters
COO & Chief Product Officer

I would say we're not going to go into the specifics of any of the deal -- the terms of the deal.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. I'll try one more. I'm not sure where -- what I'll get. But Microsoft, look, is the deal -- can this be broader? And can it be a more strategic partnership beyond advertising? Can it involve elements of cloud, gaming, perhaps other things over time?

Gregory K. Peters
COO & Chief Product Officer

Yes. So a couple of things there. First of all, we picked Microsoft as our ad partner because we think they're going to be great as an ad partner. So that was really the criteria that was used to inform how we thought about the choice on, you mentioned, cloud. We're super excited about Amazon and our partnership with them, and we haven't changed that relationship. We haven't changed our focus on AWS as essentially our cloud infrastructure partner there.

So we also have -- we've done other stuff with Microsoft. We continue to do work with them on sort of go-to-market partnerships, things like that. We'll look for those opportunities as they exist with Microsoft and with other companies as well. So I would say this doesn't foreclose on anything like that. But you should think about this was about a great ads partnership deal at the end of the day.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. Great. So let's shift gears, talk about account sharing a little bit. You put out a blog post yesterday kind of expanding your efforts to monetize account sharing in LatAm across 5 new markets but a slightly different implementation than in the first 3 countries that you announced in March. Just curious what you've learned here early on over these last few months and just how you're thinking about these different implementations going forward.

Gregory K. Peters
COO & Chief Product Officer

Yes. First of all, it's excited to -- I'm excited to get to the stage. We've been sort of working behind the scenes for almost 2 years in building the technical capabilities to get this stuff rolled out, and now we actually get to put something in front of consumers and see how they react. And this is sort of where the rubber meets the road. So we've got the 2 models, as you expressed.

Essentially, both of them are similar in that they ask consumers not to stop sharing so much but just to pay a little bit more for different forms of sharing. And the first model that we deployed it was pay a little bit more to add a member and share with those additional members. The second model we're trying is pay a little bit more to add an additional home and share the account with the additional homes.

So really, at this point, we'll sort of see what works for consumers. That's obviously the reason we're trying these different approaches, is to learn more. We're learning a lot every day on a daily basis at this point in time based on what we've deployed. And I would say while it's early to call it, obviously, we just are getting going on the second approach, so we'll learn more from that.

I would say we're tracking quite well to sort of the plan that we had in place. And I am increasingly confident that based on what we're seeing, that we'll have something that we can deploy next year as we were planning.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. And can you talk about some of the technology that you're using here just to ensure that you're not limiting access for legitimately paying members who are traveling or perhaps away from home, whether that's IP addresses or device ID or other things?

Gregory K. Peters
COO & Chief Product Officer

Yes. And one of the reasons we've been working on this quite some time is because we were building those capacities in the background. So -- and these are mostly technical implementations, I understand, through a variety of network signals and stuff, what is happening. But then we're sort of putting it through the lens of the consumer-facing model. And so -- and each of these 2 approaches have slightly different characteristics.

But generally, we're trying to lean into a consumer-friendly model that supports legitimate use cases. And travel is a good example of that, personal device use, using your mobile phone as you go around the world, your PC, things like that. So supporting those legitimate use cases, but also making sure that we're doing a good job at getting paid as a business when we're delivering entertainment to folks outside that household or that home in a way that is reasonable where we're asking for a little bit of extra monetization to make that happen, make it a smooth transition as we can for users and really trying to balance that sort of very consumer, pro consumer, consumer of choice model with what we think are practical considerations of the business. So those approaches are different, and that's obviously why we're trying these different things to figure out sort of which is going to work better in managing that balance point.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. And timing here, I think you said, is also 2023. Does -- do you need to have account sharing and kind of lining up with the advertising tier rollout? Or are there some benefits in doing that? Or is it not kind of strategically important to you?

Gregory K. Peters
COO & Chief Product Officer

We're pursuing both independently because we think that there's value to the business and value to consumers, frankly, especially on the ads plan with a wide range of prices. So we're pursuing them independently now. There's a great synergy that happens when -- as we think about on sharing and paid sharing.

Part of this is being able to offer to a range of folks who may be borrowing Netflix because they didn't quite see as much value from the entertainment and the viewing to sort of motivate getting their own plan. That's part of that segment. Part of the segment, we just have to encourage them, push them and nudge them to get to that point. But part of what's great about ads is that obviously, we get to give folks that are seeing a little bit less value, a lower price and be able to convince more of them to sign up through that ad plan.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. Ted, we're going to talk about content, I promise. All right. So maybe you can talk a little bit about how content performed in 2Q and how you're thinking about it into the back half. Stranger Things, obviously, your best English series debut of all time, Stranger Things 4, but go ahead.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. I think these titles continue to hit new heights, which is really fantastic that we could still be doing this back to back and delivering hits on top of hits, and I think that really belongs to the content teams that do such a phenomenal job around the world. Bela Bajaria, who heads our TV group, they keep surpassing records like we have been able to do with Stranger Things and Bridgerton and Squid Game.

And our biggest hits have all come out in the last 12 months, which is really kind of a phenomenal sign of progress. Scott Stuber and his film team, really killing it. Again, I'm going to call back to the Friday release of Gray Man, because I think it's an unbelievable proof point of what kind of films that this team can put out. I think that this is -- and again, this is kind of back to back to back, where I think Gray Man will join Red Notice and Adam Project to be -- and Don't Look Up as among the most popular movies of the year, not just on Netflix, but period. And I think that really is a testimony to these teams and the teams around the world, working great with creators to create a platform for them to do the best work of their lives.

So we've been really pleased with the output. We've been pleased with the performance. 35 of our original shows are nominated for Emmys this year, which says a lot about the work that's coming out, including 3 best drama nominees, which happened to be among our most-watched shows on Netflix ever. So the fact that they could be crowd-pleasing and award-winning is a pretty tough and pretty gratifying combination.

Spencer Adam Neumann
Chief Financial Officer

And to kind of toot Ted and the team's horn, driving engagement, which is really the North Star driving viewing because then we can drive member growth and monetization around it. And as we referenced in the letter using the U.S. market as an example, Nielsen is going to be reporting later this week, 7.7% screen time share for Netflix, which is the highest we've ever been, which is again testament to the team and the quality and engagement of what they're delivering.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

All right. Hopefully, they won't mind that you gave that number a little early. Okay. On -- let's go back to Gray Man for a minute. Ted, how are you approaching the marketing differently perhaps for this title versus some of the other big movies that you've had in the past?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Well, I think you've seen a lot of it out there. I think we've done -- based on the marketability of the projects themselves. This is why our marketing spend is a bit lumpy because they really are trying to focus on the titles that mean a lot to our members and that created a lot of excitement and conversation around the world. Gray Man is certainly one of those movies that's going to attract a very broad audience. So you'll see the marketing spend out there pretty aggressively.

I would -- I want to point out, Marian Lee, our new CMO, is doing a phenomenal job. She came from inside of Netflix. She was running the U.S. She hit the ground running with that remarkable Stranger Things campaign, I think our best campaign to date, one of the strongest marketing campaigns I've ever seen. And she's in the -- back to straight up with Gray Man. So I think these campaigns are really doing a ton to bolster conversation around the world around these projects. So it's not enough just to watch, but also to get your friends to watch with you, too. So it helps bring folks along in the conversation.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

So with Stranger Things 4, your best English series debut of all time, which we talked about. Are there ways that you can leverage that record-breaking viewing to drive engagement with other shows and learnings that you can take to build out additional franchise content?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. Look, I think that time spent is such -- the engagement is such an important metric because the time spent on Netflix made you come in and you're exposed to everything else we're doing as well. And Greg and the product team did such a phenomenal job of audience matching to put the most relevant thing in front of you and when you come to Netflix, that you're bound to be exposed to something you're going to love.

You also see it in the kind of that targeted post-play mechanism. So once you get through that last episode and you're getting that one second of anxiety of what am I going to watch next, you've got a couple of great choices in front of you. And folks use that tool all the time to find the next great thing to watch on Netflix.

So it's a pretty great audience where I think it's rewarded in that when the more you watch, the more you'll find great things. So I think we get a Stranger Things that really pays off. We get a Gray Man that really pays off. We just got to do that constantly, Doug. The idea is that not only can we deliver on that but people should expect it back to back.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

And Ted, how do you balance out driving both that high-quality content and the significant scale? Because you're clearly releasing a lot of content on an annual basis. Does anything change in your process around content going forward?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Look, I think the focus on quality has always been there, and it's intensified as competition intensified. So I think we've got to really focus on working tightly with the great -- I think the output of great content is generally the result of 1,000 great decisions. And the most important one is the creator that you're working with and picking people who really want to win for the audience and working with our teams to create great TV shows. It can go on for multiple seasons or great movies that spawn sequels or just great content that comes in and lives through its life and episodes and makes people feel great.

So I do think that the focus on quality, and the thing that I've always said from the beginning is scale. Scale is the thing that we're going to do that no one else has ever done yet. And the way that we're doing it today is that kind of distributed decision-making among the teams, the decision-making in -- on the ground, in country for our teams making original content is what enables this thing to scale. If it all bottleneck behind 1 or 2 or 3 decision-makers in California, we wouldn't be able to do what we're doing today for sure.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. So to support that content, you've talked in the past about kind of the $17 billion to $18 billion spending for this year. Spence, if you can update kind of how you're thinking about it for '22. And as we talk to investors, there's probably about half of them that actually want content spending to come down some and to be kind of reined in a little bit. And then the other half wants that to continue to grow and find more hits and go more globally.

Spencer Adam Neumann
Chief Financial Officer

Have one more and have one less, Doug. Have one more walking into our life.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

I hear you. How do you think about that content spending going forward?

Spencer Adam Neumann
Chief Financial Officer

Well, sure. I can take it. And maybe, Ted, you chime in. As you said, we're expecting to spend on -- cash content spend about $17 billion this year, Doug. As we look forward, 2023, next couple of few years, say, we're probably in about the right ZIP code. So cash -- we've come through a pretty big business transition for us and the most cash-intensive portion of that transition over the last 5, 10 years where we moved to original -- Netflix Originals predominantly and producing our own content largely. So about 60% of our content assets on the balance sheet are produced content. So that's been a pretty big transition. We've come through that.

And then also cash content spend is a little bit choppy. So we went through a bit of that COVID wave. We were coming out of COVID. We've got into production when we could, as quickly as we could in some things, including when talent was available. So that pulled forward some cash content spend in '21 and '22. So I'd say just generally, when we look out the next couple of few years, we'll be probably right around in that ZIP code, which puts us in a good place. And also, as we said, we were trying to work through moderating our growth in content expense. So our content expense will continue to grow, but it's more moderated as we adjusted for the growth in our revenue. And we think we've gotten a lot smarter over the last decade or so being in the originals business as to where we can direct our spend for most impact, highest impact and highest satisfaction for our members. So that's about roughly how we're thinking about it.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

We spend...

Spencer Adam Neumann
Chief Financial Officer

I don't know who that makes happy, by the way. I don't know if it makes either one of them happy.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Just half of them. I would say, look, we spend -- the way we spend to get to where we are today, and we think that we're about in the right ZIP code. And as like Spence said, that COVID distortion in the last 2 years kind of make it a little murky. But in general, I think that we're kind of in the right ZIP code, I agree.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

Doug, just to give you a sense, we have about time for 2 more questions. But Reed, I think you want to add something.

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

Ted, maybe just talk about Stranger Things 4 as an example, how much did COVID inflate the production costs in your view?

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Well, that particular show was probably affected as much as any because of the young cast and the size and scope of the production and the multiple locations we shot in. So it was a very expensive burden on the show to make sure that we could deliver it. One of the catalysts of splitting the season in half was how long it took to produce that show, and a lot of that was stalled because of early shutdown of the production and restarting production and being extremely careful with the cast of the show early on in COVID. So it was more financially impacted than a lot of our other projects were. But -- and again, I think if you did that all again, that spend off the top, you might even get a couple of extra episodes out of it.

Spencer Adam Neumann
Chief Financial Officer

And more broadly, maybe the way to think about it is throughout COVID, we were, at various times, 5% to 10% of our overall spend was kind of COVID-related costs that it started higher, worked down lower. So on these kind of numbers, that's significant. And it's obviously much smaller now, but that was a big kind of drag on our overall efficiency of spend...

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Yes. And that wasn't an overall 5% across all production. Some of them impacted a lot more than others.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. I want to make sure we talk about operating margins and, of course, free cash flow. So operating margins, Spence, I think you're talking about 19% to 20% for this year, but ex restructuring and then also I think the FX changes from January when those numbers were first provided. So maybe you can just provide a little more context there.

Spencer Adam Neumann
Chief Financial Officer

Yes. So when we had our call, we basically are holding to our margin guidance. So at the beginning of the year on the Q4 '21 calls, so as we started launch and started this year, we said we already saw kind of slowing revenue growth. And we said given the slowing revenue growth, we're going to maintain -- we're going to manage to a 19% to 20% operating margin before any impact of major swings in FX, and that's what we're still holding to. So this year, we've got the FX moves, and we also mentioned the $150 million of restructuring. We're not expecting more restructuring costs throughout the year. So that's what's baked into it, and we're holding to our margin guide and similarly holding to it for '23.

So basically, we're saying until we reignite revenue growth, we're holding flat to that margin guide. So overall, underlying very healthy operating metrics. I mean when you look at the revenue side, it's -- we're tracking -- it was 13% constant currency revenue growth this quarter. We're guiding to 12% next quarter. You can see the read-throughs in a kind of a similar range for the full year and to 19% to 20% operating margins for this year and next. But obviously, the strengthening of the U.S. dollar is a major outlier, and we just need to kind of work through that and operate our -- as best as we can on what we can control in the meantime.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. And on free cash flow, so 2022, really your first year of sustainable kind of strong free cash flow. You're talking about $1 billion or so for the year. How are you thinking about some of the key puts and takes around that? And what does substantial growth mean in '23?

Spencer Adam Neumann
Chief Financial Officer

Well, it will be more than the roughly $1 billion. So again, the numbers we provided are again assuming no major additional kind of big swings in FX. So hopefully, we've seen most of that given the extraordinary moves in the last 3 to 6 months, more than we've seen in the last 20 years. But as you say, we're guiding to $1 billion, plus or minus a few hundred million of positive free cash flow in '22. We think that will continue to grow substantially next year. It's a combination of what we said before. We're through that kind of cash-intensive transition of our business. We're also operating about kind of roughly similar levels of cash content spend next year as this year. In fact, as we said, we pulled forward a little bit of cash spend into '21, '22. So those things are kind of working in our favor as we continue to scale the business.

So I don't want to put a specific number out there, but assume it will be kind of meaningfully more. And then obviously, as we kind of work through what we expect to do in terms of accelerating our revenue growth and then start ramping up operating margins again. And hopefully, there's a little bit of reversion on these various global currencies. All those things accelerate cash flow generation down the road.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Okay. And then we just want to maybe close out with what content each of you are most excited about in the back half. And I don't know if it's Gray Man for everybody or not, but I'm sure there's a lot of other good things.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director

Well, Gray Man has a recency advantage for sure because it's coming on this Friday, and it is mind-blowing.

Spencer Wang
Vice President of Finance, Corporate Development & Investor Relations

For me, Doug, I'm super excited for Knives Out 2. I've heard great things from our content executives on that one. So definitely anticipating that one for me.

Gregory K. Peters
COO & Chief Product Officer

Spencer, you beat me to the punch there. I'm going to go Knives Out 2. But I'll flip back to what I'm currently watching, which is Umbrella Academy, which is a great current season.

Spencer Adam Neumann
Chief Financial Officer

I'll jump in and let Reed close it out. I just -- I've been going through Stranger Things to catch up. I just finished that, and I am really looking forward to Extraordinary Attorney Woo. I'm hearing great things from everyone throughout the hallways, and I'm excited to watch it soon.

Wilmot Reed Hastings
Co-Founder, Chairman, President & Co-CEO

I'm going to be in trouble because we just watched Michael Pollan about hallucinogenics, and a great documentary series.

Douglas Till Anmuth
JPMorgan Chase & Co, Research Division

Changing your mind.

Theodore A. Sarandos
Co-CEO, Chief Content Officer & Director
Thanks. Thanks a lot, Doug. Billions of people around the world love streaming TV and film, and we only serve a few hundred million of them. So the opportunity for growth here is enormous. We have some headwinds right now, and we are navigating through them. Remember, this company and this team has navigated through a lot of change in the last 20-plus years. We've seen entertainment formats come and go. We've seen entertainment business models come and go, and we have managed to grow through all of them through all kinds of economic conditions and through all levels of competition. So we're super confident that as long as we make the films and the TV series and the games that people love, we're going to continue to lead this exciting and young industry. Thanks a lot, Doug.