

Netflix, Inc. NasdaqGS:NFLX

FQ4 2023 Earnings Call Transcripts

Tuesday, January 23, 2024 9:45 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2023-			-FQ1 2024-		-FY 2023-			-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	GUIDANCE	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	2.23	2.11	▼(5.38 %)	4.14	4.49	12.25	12.03	▼(1.80 %)	15.94
Revenue (mm)	8712.44	8832.82	▲ 1.38	9260.66	9240.00	33637.60	33723.30	▲ 0.25	38223.56

Currency: USD

Consensus as of Jan-23-2024 6:57 PM GMT

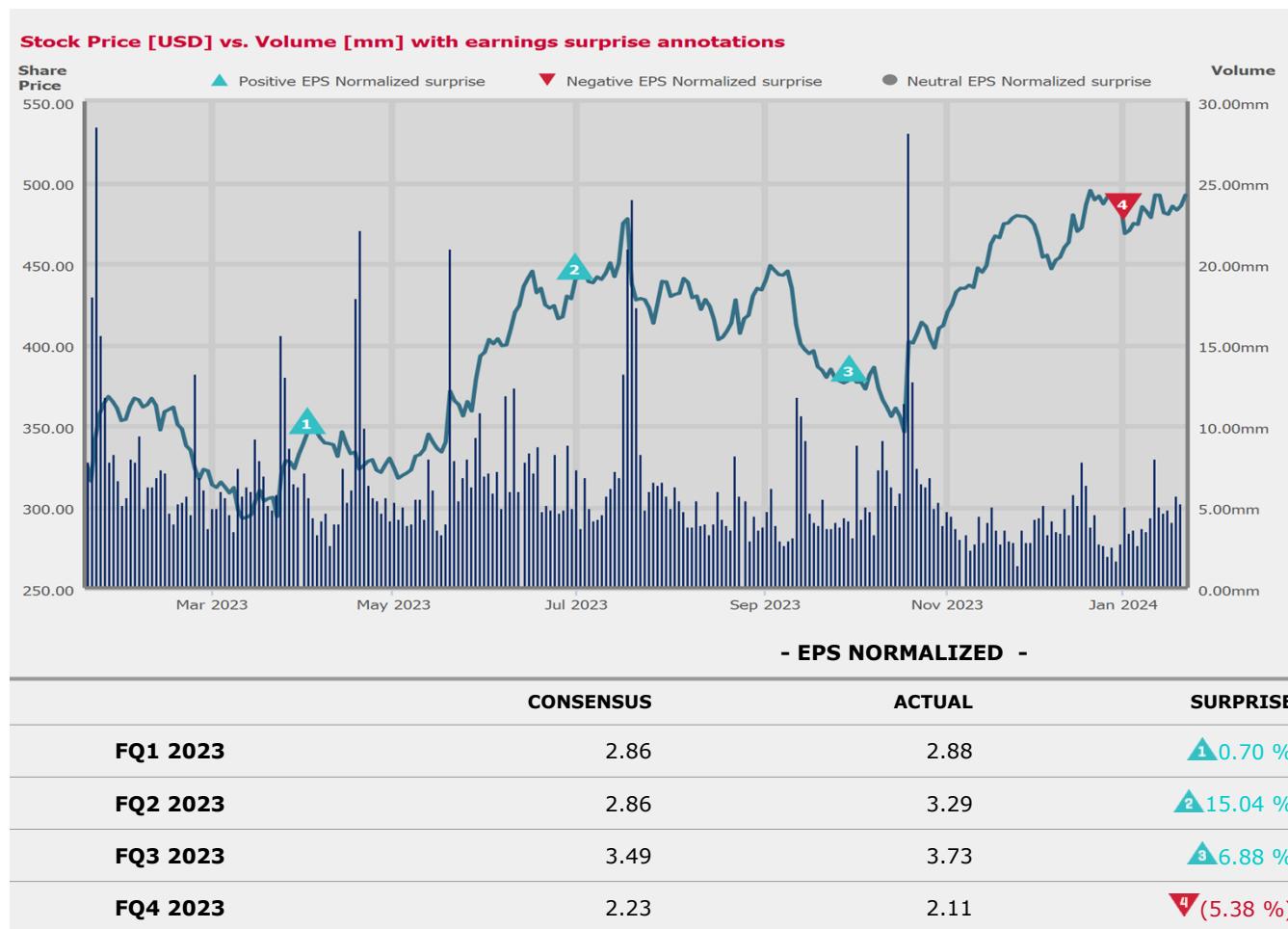


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Call Participants

EXECUTIVES

Gregory K. Peters

Co-CEO, President & Director

Spencer Wang

*Vice President of Finance,
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Spencer Adam Neumann

Chief Financial Officer

Theodore A. Sarandos

Co-CEO, President & Director

Presentation

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Hello, and welcome to the Netflix Q4 2023 Earnings Interview. I'm Spencer Wang, VP of Finance, IR and Corporate Development. Joining me today are Co-CEOs, Ted Sarandos and Greg Peters; and CFO, Spence Neumann.

We do have a few changes to our interview format this quarter. First, we are live streaming this over YouTube. So hopefully, it's working. I guess we'll find out shortly enough. Second, we've collected questions from the analyst community, and I'll be reading those questions and moderating the interviewer -- the interview.

As a reminder, we'll be making forward-looking statements, and actual results may vary.

Question and Answer

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

With that, let's dive first into the first set of questions, which is about our new partnership with WWE that we announced this morning. For Ted, the first question comes from Dan Salmon. Can you please expand on the decision to acquire WWE Raw rights? Is the WWE audience, one that is underpenetrated for Netflix today? And can you expand on the economics or the cost of the deal, please?

Theodore A. Sarandos

Co-CEO, President & Director

Thanks, Dan. If I could raise a single eyebrow one at a time, I would lean into the camera with the single eyebrow and do my best way in. But I'm going to say instead that we are thrilled to bring this WWE Live programming to our members around the world. WWE Raw is sports entertainment, which is right in the sweet spot of our sports business, which is the drama of sport. Think of this as 52 weeks of live programming every week -- every year. It feeds our desire to expand our live event programming. But most importantly, fans love it.

For decades, the WWE has grown this multigenerational fan base that we believe we could serve and we can grow. We believe that WWE has been historically under-distributed outside of North America. And this is a global deal. So we can help them and they can help us build that fandom around the world. And not to -- I should add that this should also add some fuel to our new and growing ad business. We're very excited about this deal.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

And Ted, did you want to comment on the economics or the cost of the deal?

Theodore A. Sarandos

Co-CEO, President & Director

No, we don't comment on the economics of any of our deals. I would just say this is a long-term deal that we're really happy to be in with the WWE.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Right. Our next question comes from Rich Greenfield of LightShed. Rich, first wants me to say great quarter to you all and his question is, should we think about the WWE deal as fitting into your existing plans to spend roughly \$17 billion a year in programming? Or is this expansion into live going to drive overall spending higher? And lastly, could you talk about the opportunities to create shoulder programming around WWE similar to Drive to Survive?

Theodore A. Sarandos

Co-CEO, President & Director

Well, expanding into live event programming is something we've talked about for quite a while, and this has been in the works, so we used to look at this as fits inside of our \$17 billion programming spend now. So -- and in terms of building on it, you should think about Formula One as -- like this is almost the inverse of Formula One, which is a very big and passionate U.S. fan base and a lot of room to grow outside of the U.S. And we could build that as we have with Formula One, and other sports like through our shoulder programming, like Drive To Survive, like Full Swing, like Break Point, like Quarterbacks, like Tour de France. And now with this great storytelling the events itself are the storytelling of the WWE.

So this is a proven formula for us that we're excited to jump into. This is sports entertainment, very close to our core. The deal is long term. We're super excited about it.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. And the WWE partnership has spread a lot of questions around our broader approach to sports, including a question from Ben Swinburn, but I'll read Michael Nathanson's question since he got it in first. So Ted, given the news today, is it safe to presume that you will now be interested in similar types of global sports rights like the NBA or UFC? Why is the WWE more attractive than those rights?

Theodore A. Sarandos

Co-CEO, President & Director

So unique to those other opportunities, WWE is sports entertainment. So it's really as close to our core as you can get of that sports storytelling. So -- and in terms of the deal itself, it has options and has the protections that we seek in our general licensing deals and with economics that we're super happy with globally. So I would not look at this as a signal of any other change or any change to our sports strategy.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. Thank you, Ted. I'll move this along now to a series of questions regarding our results and the forecast. First, coming from Mark Mahaney of Evercore and this is for Spence. How should we think about ARM growth going forward? Is mid-single-digit percentage increase a reasonable benchmark? And what are the factors that could create either upside or downside to that growth outlook?

Spencer Adam Neumann

Chief Financial Officer

Sure, sure. Thanks, Mark. So well, first, stepping back, 2023, as a reminder, was a pretty unusual year for us. It was essentially all member-driven growth because our pricing and plans focus in '23 was on rolling out paid sharing. We had almost no price increases until late in the year in '23. And even then, it was just a partial quarter impact. As we look to '24, as we noted in the letter for 2024, we expect healthy double-digit FX-neutral revenue growth, including growth in FX-neutral ARM. So we expect continued member growth powered by a grade slate, including the full year impact of our 2023 net adds carrying into '24 and no change to our pricing philosophy.

You saw some of that pricing action already in the past quarter. And we should get some help from extra members and starting to scale our ads business. But as we said, ads won't be a primary driver in '24. So when you look beyond in general, over kind of multiple years, '24 and beyond, we're focused on continually improving our service. If we do that well, we'll have more members or more value that we can occasionally price into and lots of engagement to build a big and profitable ads business.

So healthy revenue growth with a mixture of volume and ARM, that's really the output. And I'll probably disappoint because I'm not going to provide a specific guide on ARM because we managed overall revenue growth, but we want ARM to be a component of that growth. Just that it could move up or down based on things in any given year like FX, like the place at which we're scaling our ads reach and some lag that could happen in terms of monetizing that reach and just generally, our pricing and planned strategy more broadly in a given year.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thanks, Spence. Our next question is from Steve Cahall from Wells Fargo for Greg. The question is once a subscriber and ARM benefits from paid sharing begin to diminish in 2024, what do you think are the biggest incremental opportunities to continue to drive subscriber and revenue growth? What types of additional content or additional member benefits provide the best ROI to help sustain healthy revenue growth?

Gregory K. Peters

Co-CEO, President & Director

Well, we're excited to be at the point where we've operationalized that paid sharing product work. So it's integrated in everything we do. And we're iterating and improving on it just like we would any other significant part of our product experience. So we think of this essentially as having built a more effective engine for translating the entertainment value that we're creating for our members into revenue. But I think it's critical to understand that, that engine works on top of, and we see it working on top of, very healthy organic growth.

You can see it in things like better than forecasted churn, we see better-than-expected impact from the recent price changes we did. And that's the model, essentially, right? If we continue to improve our core offering, that means more diversity and more quality from our members' perspective and our films and series now adding the live events programming to add even more value, continue to grow games and the entertainment value that we're delivering through those, then our paid sharing work and our ads work creates a more effective engine to translate all that value into revenue growth. And will support increased conversion of our addressable market in many years to come.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thanks, Greg. The next question is from Doug Anmuth from JPMorgan. And I'll direct this one to Spence. The \$13 million plus pay net adds in Q4 was strong overall and across all regions, but EMEA seemed to drive particular upside. Is there anything specific to point out there, perhaps the ad tier or specific content or localized pricing perhaps?

Spencer Adam Neumann

Chief Financial Officer

Yes, thanks. Well, actually, EMEA is sort of a perfect example of a little bit of what Greg was just talking about. So first, it starts with great slate performance, a great content performance. We had a really strong slate across EMEA from The Crown finale in the U.K., to -- in France, we had Blood Coast and Lupin and Class Act. We had Berlin, Elite and Nowhere in Spain, and in Poland, 1670 and much more, frankly. So it starts with that strong slate. And then by channel, Greg's last answer that kind of better value translation engine, if you will, which drives even more growth through our paid sharing solutions and our monetization engine.

So that helped as well. So it really all came together in EMEA this past quarter. And I'll say, very importantly, it's not just net adds. It's again, our primary focus is on revenue growth. We had very strong revenue growth as a result of that in EMEA this past quarter. 13% FX neutral growth in Q4.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thanks, Spence. Doug also has a follow-up question around paid sharing, which I will direct to Greg. How far along are you in terms of the paid sharing benefits? Do you still believe paid sharing will add subscribers for several more quarters? And is there any way to quantify what percentage of the \$100 million borrower household population have either become extra members or full paying subscribers?

Gregory K. Peters

Co-CEO, President & Director

Yes. As I mentioned, we've gotten to the point where paid sharing -- the paid sharing product prices is something we do at this point. But also, I think it's important to say that like many other things that we do, we also see a real opportunity to continue to materially improve that value translation engine. So we definitely delivered interventions to new cohorts in the last quarter. We're going to continue to deliver to new cohorts in 2024.

But increasingly, I sort of don't think about it as like going after these certain pools, but more about just finding the most effective way to convert folks who are using the service, the right call to action, the right nudge at the right time. And those might have been historical borrowers or folks that are new to

the service as well. And we're going to continue to improve that engine. That will continue to improve our growth for years ahead, not just 2024.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. I'll now transition us to a series of questions around advertising. For Greg, Dan Salmon from New Street Research. His question is, what are some of your most important milestones for the advertising business in 2024? Do you have a target level of MAUs or ad member households, what sorts of improvements to ad tech or measurement are you seeking and perhaps any new country launches for your ads plan?

Gregory K. Peters

Co-CEO, President & Director

Yes. Our top ads priority, you've heard us say before, I think you'll hear us say it again, is scale. We saw a 70% quarter-over-quarter growth last quarter. That's after 70% quarter-over-quarter for the quarter before and then 100% the quarter before that. So that's a good trajectory to be on. We're now at 23 million MAUs, and we see that continuing to grow in the quarters ahead. As to your point about what's the target, every market is different. There's not a magic MAU number, but I think it's fair to say that we've still got plenty of room to grow in all the markets that we operate in.

And we're focused on the additional work that we can do in that space. That means making the ads plan more attractive. We've added streams, higher resolution, downloads. It means engaging partner channels. You see us do more of that. Shifting our plans and pricing structure in other places where we think it's appropriate. So all that works ahead of us. We know we can do tremendous amounts in that space, and we're going to go do it over the next quarters.

Second priority, you mentioned this, which is really growing the technical advertising features and growing our go-to-market capabilities. And these are features like targeting, improved ad relevance. That's good for members. It's good for brands. We've got tons to do on improved measurement. We want to launch more ads products. We've got binge ad sponsorships now. And we have to build increasingly the capability to be better partners with advertisers and serve their needs. So this is better sales teams, ad operations and just more capability to meet brands where they need us and how they need us.

So we're focused on the long-term revenue potential here. We're very optimistic about it. It's a huge opportunity, \$180 billion of ad spend ex-China and Russia, \$25 billion alone on Connected TV. We know ad dollars follow engagement. We've got the most engaged audience. So we believe we're well positioned to capture some of that ad spend that shifts from linear to streaming.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. And Greg, any thoughts to Dan's question around launching an ads plan in other countries in addition to the 12 countries we're in today?

Gregory K. Peters

Co-CEO, President & Director

Thanks for reminding me on that one. I would say we have got a ton of work ahead of us on just getting to the level of maturity and impact to the business from the countries that we're operating in today. I would say, never say never on expanding beyond that, but it's worth noting that the countries that we are currently operating in represent about 80% of global ad spend. So we're already working in the spaces where there's the majority of opportunity. We'll see in the fullness of time, but I'd say we've got years of work ahead of us to take the ads business to the point where it's a material impact to our general business.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Greg. From Steve Cahall from Wells Fargo. How do you think about the efficacy of continuing to use a third-party relationship for ad sales versus the opportunity to invest in your own ad tech and ad sales infrastructure? Do you have a sense of what kind of investment would be required to transact more directly with advertisers?

Gregory K. Peters

Co-CEO, President & Director

Yes. And just to clarify, we are already in partnership with Microsoft developing part of the technology that supports our ads experience. So they've got a large team working on some of those features that I just mentioned, but we've got a smaller, but growing team, working on the areas where we can differentially contribute to. And then similarly on the ad sales and the go-to-market side of things, we're building out our own teams that cover a portion of the sales and operations activities.

So I think you asked in terms of what's the size of investment, we have plans to continue to grow those teams. So those are both growing at a pretty strong clip and growing that investment. But we've modeled out where what we think we need. And even with those investment levels and the growth that we expect -- that we see, we expect the margins on the ad business to remain very high.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. A question from Rich Greenfield on advertising. Later this week, T-Mobile's subscriber benefit called Netflix On Us, will convert to Netflix' ad tier unless subscribers upgrade to an ad-free tier? Is it reasonable to assume that your U.S. ad-supported subscriber base will roughly double as a result of this change? And assuming it is, how quickly will you be able to fill that inventory?

Gregory K. Peters

Co-CEO, President & Director

Yes. I won't get into the specifics of a particular deal or provide a forecast for a particular deal, but I'll just say that just as we've done for many, many years, leveraging partner channels is an important part of our subscriber growth strategy. We're applying the same techniques and approaches to scaling our ads membership. And we love having this additional tool. It's very effective, very useful for us because that lower consumer-facing price means that we got room now to bundle the ads plan into a set of lower-priced partner offerings where it was hard to make the economics work for everyone previously.

So it opens up a whole new range of opportunities. It's great for new members as well who are leveraging those bundles. They get a better plan than basic, more streams, higher resolution with downloads. And of course, the real benefit is they get access to all these amazing stories at a lower effective price through the bundle. So we really think of this as a win-win-win and we're going to continue to leverage these bundles going forward. And I think Rich asked how we think about -- how could we fill the supply. I mean when you're building -- growing as fast as we're growing right now, it creates a lot of challenges you might expect to then fill behind that. But I'd much rather be in that position where we're growing that inventory and then racing behind to fill it and improve our monetization than the reverse. So I'm happy to have that challenge.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Super. I'll now move us along to a series of questions related to content. So Ted, from Jason Helfstein of Oppenheimer. Are you shifting the mix of your content spend to more licensed second-run content? And if so, how should we think about this mix impacting Netflix's operating margins?

Theodore A. Sarandos

Co-CEO, President & Director

So we've always had a healthy appetite for licensing content from others for our members. I don't see any meaningful change in that mix. And the current margin outlook contemplates a healthy mix between originals and licensed titles. It might be that we can deliver more on our programming spend with

some licensed titles, but we also believe that we deliver an incredible amount of value, excitement and differentiation with our original series. Remember, our original series made up the number -- we're the #1 most watched original 48 to 52 weeks last year. So we really don't have any plans to move away from those investments.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. And another question for you, Ted, from Rich on content. While Netflix data clearly shows that new original movies outperformed licensed titles in terms of viewers and viewed hours, it doesn't appear that new movie -- those new movies are having the same cultural impact the TV series have. Do the recent management departures or the willingness of Hollywood Studios to license post theatrical movies on Netflix, signal any sort of meaningful shift in our film strategy towards licensing away from original production?

Theodore A. Sarandos

Co-CEO, President & Director

Yes. No, look, our original movies are attracting some of the biggest audiences in the world. Look at Leave the World Behind in Q4. Look at all those crazy names about the creepy deers they were all over the place when the movie came out or look at Society of the Snow from Spain right now this morning was nominated for 2 Oscars or even look back last year, Jennifer Lopez's great movie, The Mother. By some accounts, it was the most watched movie in the world last year. So I think about it that fans really don't care much about budgets and windows. They just want a movie that they love. They want a movie to make them cry or make them laugh or give them something great to talk about over dinner.

As you pointed out, our original films do outperform those licensed films, and they do uniquely distinguish us from the competition. Just this morning, our original films got 18 Oscar nominations across 10 different films. So we do not plan to change our strategy or the mix. It's always going to be that kind of blend of first window, second window and deep catalog. We think that formula works best to entertain the world.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. And as a follow-up to that question around licensing, Ted, your competitors have largely abandoned their opposition to licensing catalog content in Netflix. We've seen, for example, NBC's Suits, HBO's Six Feet Under and more recently, a series of Disney TV titles on Netflix. Do you think your competitors should begin licensing your new original series as well versus keeping them exclusively to their own streaming services?

Theodore A. Sarandos

Co-CEO, President & Director

Yes. I mean I guess I'd call you back to that history again and just say we've got a rich history of helping break some of the TV's biggest hits like Breaking Bad and Walking Dead or even more recently with Schitt's Creek. Because of our recommendation and our reach, we can resurrect a show like Suits and turn it into a big pop culture moment but also generate billions of hours of joy for our members. So I think you get to remember the studios have always been in the business of selling their content to others, including direct competitors for years.

I believe because, again, of our distribution heft and our recommendation system that sometimes we can uniquely add more value to Studios' IP than they can. Not all the time, but sometimes it does, and we're the best buyer for it. So I am thrilled that the studios are more open to licensing again, and I'm thrilled to tell them that we are open for business.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. And a question on animation and animated features from Rich Greenfield as well for Ted is, Leo, Netflix's most successful animated film to date. It's been heavily watched based on our top 10 data.

Is there any color you can provide on repeat viewing the film? And why has this animated feature film resonated versus other Netflix animated feature films?

Theodore A. Sarandos

Co-CEO, President & Director

I think Leo has resonated for the same reason that Sea Beast did last year. It's great. People really love it. It brings a lot of joy to families. And yes, they do watch them over and over again, which drives a lot of engagement, but also drives a lot of attachment. I think that Leo and Sea Beast are proof points that we have the flywheel to create original IP in that animated space, and there is so much appetite for animated feature. 7 of the top 10 most watched movies since Nielsen has been tracking streaming are animated features. So I'm super thrilled with Leo. We're kicking around the Leo 2 right now and it's a film that worked on so many levels.

The animation -- the art of the animation is beautiful. The comedy is funny and families just really love it. So we look forward to a lot more. We have Spellbound coming up next year. We're just really thrilled with our -- that the animation team is now firing on all cylinders.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Moving along to engagement. This question is from Bryan Kraft of Deutsche Bank, and I'll direct this one to Ted. What have the engagement trends been like globally and domestically? Has it been steady, increasing or decreasing? And how has paid sharing impacted engagement per member?

Theodore A. Sarandos

Co-CEO, President & Director

Yes. So we're really thrilled with our engagement trends domestically and globally. This is really a story about viewing moving from linear television to streaming. The story has been constant and it continues. It's also a story about Netflix kind of leading the way with professional film and television and now games. Our engagement is a bit impacted by our paid sharing. Think about it like fewer households using the same account. So as those folks spin off and get their own accounts and we win them over with our programming, that will normalize and continue to grow.

We're really pleased with our engagement. We have shown you in graphic detail what that engagement looks like on a title-by-title basis in this engagement report we just released. And I think you see in that report about 2 hours of daily engagement with our members, which is great. And you've seen that some of our hits and even our near hits are attracting enormous audiences. So we have to keep pleasing them, and we have to do that in multiple languages, in multiple countries and all over the world. And that's -- that's we're excited about, and it's showing up in that engagement.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. Let's move on to gaming. A couple of questions on gaming. First from Justin Patterson at KeyBanc for Greg. The gaming portfolio expanded significantly last year and even added some more mainstream titles like Grand Theft Auto Trilogy. How are you thinking about sizing the investment in this area? How has engagement changed over the past year? And what are the signals you're evaluating to gauge when it's time to monetize?

Gregory K. Peters

Co-CEO, President & Director

Yes. Well, we're stoked by the performance of GTA. We had high hopes, but it exceeded even those high hopes. So that's a -- it's a great place to be. So the biggest download and engagement numbers that we've seen so far. We were in the top mobile game downloads for several weeks, which shows it was not only big for us, but big numbers for mobile gaming in general. And beyond any specific title, we've tripled game engagement over the last year. So that's a solid growth trajectory for us.

Games, it's a huge opportunity, \$140 billion in consumer spend, ex-China and Russia. And we believe we can build games as strong components, and other content category to deliver entertainment value to our subscribers. But to your question on size of investment, we thought about this as we've got to allocate enough to the initiative to ensure that we're playing to win, that we have enough activity in the space that we're learning and growing, but also recognizing that we had a tremendous amount to learn and a tremendous set of institutional capabilities to develop.

And we wanted to make sure that we weren't growing that investment significantly before proving to ourselves that we can actually effectively translate that investment into member value. So things are going well. We continue to see this level of engagement growth and we continue to see what we've been seeing so far, which is evidence, as we would expect, that, that engagement leads to business benefits like increased retention, then we'll be able to scale that investment appropriately. Having said all of that, it's still, I'll use the early days, words that we love to use. And it's worth noting that our games investment is very small fraction of our overall content budget right now.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. Greg, a second question on gaming from Michael Packer of Wedbush. He asked, given the outperformance of Grand Theft Auto Trilogy on the Netflix service, will you reconsider your focus on games available exclusively on the service? Asking you will seek to emulate the success of Grand Theft Auto by offering games like Candy Crush or Fortnite on Netflix as well?

Gregory K. Peters

Co-CEO, President & Director

Yes. Licensing games, existing games with often with some form of exclusivity, that's been a key part of our strategy, and it's going to continue to be so. We've clearly seen, 1 of the things that we've learned is that recognizable games, that's either existing popular game titles or game franchises or games that are based on well-known IP, and in many cases, that's IP from our own films and series, those are the ones that are working the best for us right now. So we're going to continue to find the right opportunities to bring those kind of titles to our members. We're going to look for more great licensing and some exclusive licensing, so we can do things more like what you've seen us do last quarter with GTA, but also other titles like Football Manager 2024, which performed very well for us. Money Heist or La Casa de Papel, which was great. You'll see it this quarter with titles like Virgin River, so that's definitely the strategy that we're on, and you'll see us do more of that work.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. We have a question also from John Hodulik of UBS. This one, I'll point to Greg, but Spence, you can feel free to join in as well. The question is, how should we think about pricing changes in the rest of the world now that you are through the majority of the password sharing implementation and in light of the recent price adjustments in the U.S., U.K. and France?

Gregory K. Peters

Co-CEO, President & Director

Yes. As we had talked about previously, we largely put price increases on hold while we were rolling out the paid sharing work because we saw that as a form of substitute price increase. Now that we're through that, we're able to resume our sort of standard approach towards price increases. You've seen us do that in the U.S., U.K. and France. Those changes went well, better than we forecasted. And we'll continue to then monitor other countries and try and assess when we've delivered enough additional entertainment value, we look at engagement retention acquisition as a signals there. so that we can go back to members and ask them to pay a bit more to keep that positive flywheel going.

And we can invest in more great film series and games for those members. So the summary statement might be back to business as usual. And Spence, I don't know if you wanted to add anything there?

Spencer Adam Neumann

Chief Financial Officer

I think you nailed it, you're on a roll. So it's good.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. I'll move us along now to a couple of questions on competition and the competitive landscape. The first question comes from Maria Ripples of Canaccord Genuity. With ads coming to Prime video at the end of this month, and given Amazon is making it the default option for its prime members, could you talk about how you are positioning Netflix relative to the competition when you're speaking with advertisers? Could you also comment on if Netflix considered making the ad tier the default option similar to Amazon? And what were some of the pros and cons about that decision? So I'll turn that one over to you, Greg.

Gregory K. Peters

Co-CEO, President & Director

Yes. We did consider making it the default option. But given our long history of not having ads, we thought it was better for our members rather than force them into a change and give them ads. But better to attract them to the ads plan for the ones that wanted it based on the benefits, more streams, higher resolution downloads and of course, the lower price to be able to access all these incredible stories. So I mentioned the growth numbers we were seeing previously and the rate of growth we are on. So I think that approach is generally working well for our members, and we haven't seen any big backlash as a result, which is positive as well.

And then in terms of competitive positioning, probably the most important thing to start with is the market's big, right? We talked about over \$25 billion in CTV ad spend alone. So there's room for multiple players, clearly. And when we think about how we compete for some of that ad spend, I really think we need to play with it to our strengths. We've got an incredibly engaged audience, the most engaged audience who are watching the most culture-defining films, series and live events. That is an important place for brands to be, and it's something that differentiates us from our competitors. So that's the space that we're going to play in.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Super. Another question on competition. This one probably best for Ted and Spence to take. It comes from Eric Sheridan from Goldman Sachs. How does the current competitive landscape or content impact the trajectory of Netflix's own content spending in 2024 and beyond? Is it possible that the company could widen its competitive moat on the same or lower absolute amount of content spend?

Theodore A. Sarandos

Co-CEO, President & Director

I think it's always been a competitive place for the top programming. I think that will continue. And that's really what I think what you're talking about is whether when the top titles come to market when the big packages come and everyone's duking it out for them is going to remain to be pretty competitive. I think that we are reinvesting at a very healthy rate. We see that in the engagement. We see that in the retention, and we see that in the subscriber growth. So I don't think this would be the time to try to test that. And Spence, I don't know if you think differently, but...

Spencer Adam Neumann

Chief Financial Officer

Yes. I would just say -- just to reinforce that, I mean, we've seen the benefits over time of continuous improvement, great execution and focus and kind of gradually building our business and doing it really well and thrilling our members. And so you see it like we are increasing our content spend and coming out of the strikes in '23. We're trying to get back up to as much as \$17 billion of cash content spend this year. And as we've also said over the last few years as we kind of reaccelerate our revenue growth, which we're

seeing in the business, we hope to sustain that healthy revenue growth, grow profit and profit margins over time and then reinvest a good portion of that back in the business, which means increasing our content spend.

So we do plan to do that, but we want to do it in a smart, judicious, responsible way. And obviously, today's even announcement with WWE is a case in point. We believe we have room to do that while still staying very disciplined in terms of our overall content spend in our business performance.

Theodore A. Sarandos

Co-CEO, President & Director

Yes. I think the perception of overserving thrilling content to our members has served us pretty well.

Spencer Adam Neumann

Chief Financial Officer

Yes. And we've got lots of room to grow, obviously. And so we just want to do it in a disciplined way.

Theodore A. Sarandos

Co-CEO, President & Director

No question.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Yes. Another question from Eric Sheridan from Goldman Sachs. A bigger picture question. Given the scale of audience that has been built by Netflix, how do you think about the potential for new areas to widen your exposure to verticals or formats of media consumption? I think maybe Eric is referring to short-form content or, things like that, Ted.

Theodore A. Sarandos

Co-CEO, President & Director

I would kind of call back to something that Greg alluded to earlier. In the areas of business that are in our core, movies, television and now games, the -- that business, we're getting -- we're capturing about 5% of consumer spending. In our most mature markets, we're getting about 10% of TV time. So in our very core business, we still have an enormous room to grow. So when I look at that, it doesn't make me think about searching for more inorganic growth in different kinds of programming. There's so much room to grow in this bit of programming that we're kind of hopefully getting better and better at it for our members every day.

So there's a lot of adjacent businesses that are not necessarily competitive and are certainly complementary in some ways. Some of those platforms that you're talking about maybe in the user-generated space have turned out to be great marketing tools for our professional content. So I think we're rightfully focused, I think, on the core of professional storytelling.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. I'm going to move this over to a few questions around capital allocation. The first is from Brian Pitz of BMO Capital Markets. Basically, the question for Spence is, can you help us frame your M&A views over the next 12 months? Is there the possibility for mobile gaming, aqua-hire or what other sorts of M&A activity would Netflix be interested in?

Spencer Adam Neumann

Chief Financial Officer

Well, thanks, Brian. We're not going to speculate on kind of potential M&A activity. But as you know, our historical bias is to build and not buy. We try to be very responsible in terms of our capital allocation philosophy. We hold a modest amount of debt. We're currently holding \$10 billion to \$15 billion of gross

debt. We fully fund our business and new initiatives. You see that in terms of our investment into ads, into live, into games, while still growing the business. And we'll look at selective accelerators to that organic growth. We have done that. But we're not interested in some of the big linear assets that may or may not be available. We also noticed that -- noted that in the letter. And so I think that's how you should kind of think about our -- what's out there to go after.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

And staying with you, Spence, another question on the capital allocation. This one coming from Alan Gould of Loop Capital. We know your general rule of thumb is to have cash equal to 2 months of revenue. How big of a factor is the current stock price and your buyback activity and some of your debt begins maturing over the next few years? What do you believe is the optimal leverage ratio to maximize shareholder value?

Spencer Adam Neumann

Chief Financial Officer

Yes, sure. So I'm glad you asked because I missed the last piece of our capital allocation philosophy, which is to hold about 2 months of revenue in the form of cash on the balance sheet and then to return the excess cash to shareholders over time. We've done that in the form of buyback. And so with a little over kind of \$7 billion of cash on the balance sheet at the end of the year. And with, as you say, the kind of the -- our expectation for strong cash flow build in the year, roughly \$6 billion is what we're projecting at current FX rates for 2024. You can expect that we'll continue to return excess cash to shareholders through the buyback.

We don't try to time the kind of stock price. So we really are caught in more in a, call it, more of a price averaging sort of approach and that we buy back over time as we have excess cash.

And then in terms of optimal leverage ratio, look, we -- we are fortunate to you have continued to strengthen our balance sheet. We had a recent upgrade from Moody's in Q4. We continue to grow into that investment-grade balance sheet. But we we're pretty intentionally underleveraged, frankly. We think the optimal -- without getting overly specific, we think -- essentially, as I said, our capital allocation strategy has served us well and that philosophy served us well over the past handful of years. And we think that flexibility in the balance sheet also serves us well to adapt to a quite dynamic industry.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. I think we'll wrap up with 1 final question. It's actually 1 question we've gotten from several different analysts. And in the spirit of WWE, probably a good one for Ted and Greg to tag team on. The question is, what are your key 2024 priorities? Maybe, Greg, first to you?

Gregory K. Peters

Co-CEO, President & Director

Sure. I think you've heard us express this multiple times this call. But we just -- we see so much potential and so much opportunity ahead of us in our core business. We got hundreds of millions of qualified households out there that are still yet to sign up for Netflix. I can't believe it, but they're there, and we've got to win them over. There's many hours, like billions of hours of TV time that we are not currently winning. Growing along those 2 dimensions, more households and more moments of truth. We call them more entertainment value delivered is the key priority for us.

We want to improve our entertainment offering to do that. That means delivering more stories that our members love. Films, series, games, now live events. That's the key to that success. And then on top of that, we're focusing on improving how we translate all that additional entertainment value into revenue and improved operating margin. It means growing our ads business. It means growing general plans and pricing optimization. That's the major area of work there. So that's where we're going to be focused on for 2024, and we're super excited to do it. So with that, I'm -- I'll tag team to my partner and co-CEO.

Theodore A. Sarandos

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Co-CEO, President & Director

We'll do that instead of a sleeper hold. Look, I think everything you said is 100%, Greg, and I think it all is built on the foundation of movies and TV Series and games that people love, can't live without, talk about, can't wait to get back to post about that drives the conversation, that drives this love for programming and entertainment. So we're to start with that with next week. Greiselda, brand new show from the makers of Narcos starring Sofia Vergara, that's insane. It's so good. Following the success of one piece, we've got a brand-new Avatar, The Last Air Bender coming for fans. We've got the 3 Body Problem based on one of the top-selling science fiction books of all time from the creators of Game of Thrones.

We have a new show from the U.K., from Guy Ritchie called The Gentleman that's insanely fun. And we're back with returning seasons of Bridgerton, of Emily in Paris, of Diplomat, of Squid game. And on top of that, great movies, like the second part of Rebel Moon coming up, Damsel with Millie Bobby Brown, Jennifer Lopez's new film, Atlas, Hitman which drove everybody crazy at Sundance last night. And Eddie Murphy in Beverly Hills Cop 4: Axel Foley and so much more. It's just -- it's so fun and this is a never-ending mission to continue to improve this for our members and make sure that we're bringing them all the joy that we can.

I want to thank all the teams at Netflix, who have made that possible in 2023 and will in 2024. So I'm very excited, and I'll throw it back to you, Spencer.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Awesome. Thank you so much, Ted. Thank you, Greg. Thank you, Spence, for answering the questions from analysts. I also want to thank our audience for tuning into our first ever live-streamed video format. We look forward to your feedback and in the spirit of continuous improvement and Netflix on everything, we look forward to getting better at this over time. So thank you all again, and we'll see you next quarter.

Gregory K. Peters

Co-CEO, President & Director

Thank you, everybody.

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