Netflix, Inc. Presents at Bank of America Securities Media, Communications and Entertainment Conference, Sep-13-2023 11:20 AM

Edited Transcript of Netflix, Inc. Company Conference Presentation Wednesday, September 13, 2023 at 03:20:00PM GMT

Corporate Participants

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Conference Call Participants

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Presentation

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

So welcome, Spence Newman. We're so excited to have Netflix here, finally...

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Good to be here.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

It's very, very exciting. And we're actually in New York for the first time, which is -- it is what it is. But this -- this is the 30th year of the conference and the first time we're in New York. But in any event, there's a lot to talk about with Netflix. There's a lot going on with you guys.

So let's start with the password sharing crackdown. Can you talk about the role of paid sharing and what changes Netflix implemented between the first quarter and second quarter rollout that seems to have had a big impact-

Questions and Answers

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes, sure, sure. Jumping right into it. All right. So yes, I guess to kind of step back, when we -- the fully rolled out paid sharing, we had over 100 million borrowers out there that weren't paying for Netflix. So it was great to have all that watching but we had to -- but it was free watching, and we had to address it because if we want to drive that kind of sustained kind of flywheel of healthy revenue growth and reinvestment back into the business, better service for our members, we had to address all that free viewing.

So we were working on it for a long time, and we were working hard to come up with a solution that was good, good for consumers, good for members and good for the business. And so that's why we kind of approached it with a lens of what value we can bring to the equation- And when you think about some of those consumer-facing benefits or value propositions with things like the ability to transfer your profile more easily and transfer my -- or to manage your devices more easily or even because they were very -- there was a broad range of borrowers, things like the extra member where folks could effectively subsidize and account for their grandmother, their cousin, et cetera. So we tried to be pretty thoughtful there and balance it.

And what we saw going from early in the year, we were prepared to roll this out broadly to more than 100 countries, more than 80% of our revenue base. And we saw some opportunities. The opportunity that -- we delayed it by a quarter basically, it was pretty tactical at that point. So the solution was largely in place, but we saw some opportunities primarily to make it more intuitive, that experience for members and a little cleaner on the messaging. So those sort of small tweaks can be pretty impactful.

And that's sort of what we did. And when you see it in the rollout, what happened, you saw it in our results in Q2. We're pleased with how this is rolling out. The cancel reaction, which is the big kind of upfront risk as we kind of start to enforce and intervene on members what is -- how are folks going to react and we didn't see those big spikes.

So it was much more muted cancel reaction, better retention of our existing members, and it's been kind of healthy characteristics now going forward in terms of bringing on new paid membership, both in terms of individual accounts as well as extra members. So -- but that was really the main thing. It's not super sexy, frankly. It was some tweaks in the background, but it made it more intuitive and easier for our members.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Okay. Can you say anything about the sign-ups and what tiers they're going to-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes. So I'd say, generally, in terms of just the nature of kind of how this is rolling out, in general, one, I said it's been healthy on the retention front. In terms of sign-ups, first, it's been also a pretty healthy mix between spin-offs onto individual accounts and those extra member sub accounts, it's a little bit in favor of those individual accounts, which is good, but we want to provide value to both. But we -- fundamentally, we think having your own Netflix account is probably a better experience. But if folks want to be -- if households want to have an extra member, that's great too, and that's why we provide that.

And then in terms of the spin-off accounts, it tends to be a -- in general, it's a pretty healthy mix across our member profile. It's a little -- we've got the ad tier and the non-ads tier. The ad tier is a healthy mix in general across our plans, but it's the minority because we have multiple plans. It skews a little bit more towards ad-free in these spin-offs, so still a healthy kind of proportion going into the ad tier but a little bit higher mix into the ad-free relative to organic sign-up, which makes sense because a lot of these folks have been enjoying Netflix for a long time ad-free. So it's slightly skewed in that direction.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

And how far toward this rollout do you think you are- Even in the U.S., like a lot of people still feel like they've been untouched so far.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

I'm looking for hands in the room of whether you've -- if it's done -- yes, what we talked about in the last call, this is something that's going to roll out over multiple quarters. And so we're in the midst of that. It's a bit -- paid sharing, it's a bit front-loaded, right- So you see kind of the impact, it rolls out over at least a few quarters.

And that's just the nature of while we are -- while we've rolled it out broadly, when you think about kind of behind the scenes, the nature of our interventions and who were intervening on or enforcing on more aggressively than others, that's part of the impact. The other is just the nature of folks that are converting tend to be, at least initially, those are -- that are more engaged with Netflix to begin with. And then sometimes, it's not totally in our control, because even as we're enforcing, well, if someone doesn't -- isn't really interested in Netflix at that particular time, we have to have that right title.

So it's not until with -- its Virgin River or Rebel Moon, you pick your title that all of a sudden sparks their interest to come join Netflix. So that's why I would say, it's going to roll out over multiple quarters in terms of when you see it more in the member growth, the paid member growth initially and then it builds into revenue growth. And then it's just something ultimately that doesn't ever fully go away, right, because then we just have a better net, if you will, in order to capture paid memberships and a bigger paid membership base to grow on going forward.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

And so -- I mean, can you give us some color on like in terms of financial impact, '24 versus '23- It sounds like it's a build.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

It's a build. But as you say, there's this front-loaded impact in general, but then we have the benefit of kind of full-year impact in '24 versus partial-year impact in '23. So you have those 2 dynamics at play. So revenue is building through '24, but it's kind of that partial year, so you see the member impact -- and you're kind of through that kind of bigger front-loading of [image] but you get a full-year impact. So I'm not going to give you specific numbers, but the benefit carries through in '24.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

So in terms of specific numbers, you've never specifically said how many more than 100 million households there are. Do you want to give us any color-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

How many more than 100 million-

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Than 100 million. You said 100 million plus.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

It's 100 million plus. No, I'm not going to give you a number. It's -- there's interesting dynamics with that because folks are coming in and out of the system all the time. So it's always a bit of an estimate as to who's in the system because there's always circulation of folks who are watching Netflix or not.

But 100 million is already a pretty big number if you kind of think about our kind of growth opportunity generally. We have about -- at the end of the last quarter, about 240 million paid members. We had about 100 million or more that are kind of watching and not paying. And then there's a total universe of smart TV plus households or connected TV households of about 0.5 billion.

So there's another -- so that's -- there's another 150 million-ish there. So think of it as 240 million-ish paid members and at least that many that we still have the ability to kind of bring into Netflix either through converting kind of free watching to paid or capturing others. And then that connected TV universe is going to continue to grow over time.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

So long runway on that side. And then moving on to advertising, which is a much longer growth runway. There were press reports that said that Netflix -- that you were happy with your upfront performance or it was in line with your company expectations. Can you give us any details on like what actually you did in the upfront-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes. So we're pleased with our upfront. This is probably technically our kind of first upfront that we really went through because we did sort of a quasi in our first year, but we missed the upfront. So this was really our first upfront, it's our inaugural. And as you say, we met our expectations. So we closed deals with the major holding companies, with a bunch of independent agencies. We closed the deals at the top sort of the -- the CPM of the kind of streaming market. So we kind of preserved and reinforced the premium environment of our ads environment.

And we also started to kind of prove out that like, one, obviously, we have something that is we believe is attractive to advertisers, and we're seeing that in terms of the quality of the kind of amazing content that folks' brands and advertisements are sitting side by side with or integrated with in terms of the engagement of the audience.

And some of the capabilities we're starting to bring. So it's really still kind of really infancy in terms of innovation. But things like the ability to do sponsorships for our top 10 titles, so that was really early innovation, but something that's a bit more innovative than kind of the old legacy linear model of trying to kind of guess which titles to buy into. You kind of buy into the biggest of Netflix's dynamic basis, and we basically sold that out.

So all those things were good. But it's still -- I just want to kind of reinforce, we're still in the crawl of the crawl-walk-run stage. So it is not easy to build an ad business from scratch. We got a lot of work to do. This was a good first step. But again, as you've seen in our guidance, what we've done so far is not material to the overall revenue of the business. It's something we're building into and we have to get better across the board.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Right. And as you just said, you have had a very unique approach. I have to say, being in upfront for decades, like it was the most innovative, fast-paced, really to the point and you asked for the sale. It was a great presentation. And you talked about the capabilities, the top 10 and following viewers from show to show. It was just very interesting and very different.

But we all know you have quality premium video, it's uncluttered environment with 4 to 5 minutes an hour. You've reached all the demographics, and you have a lot going on for you. So those are the attributes. But can you maybe give us the other side- Like what are the gating factors in obtaining larger shares -- a share of ad budgets-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes. So yes, as you say, we think we have a good number of things working in our favor. And just stepping back, I'm super bullish and confident in the long-term opportunity of ads as a big -- advertising as a big incremental revenue and profit contributor to the business, but we do have to build it over time.

And there are other secular things. So it starts with just there's the natural shift of engagement from linear to streaming, and then the dollars follow. We've seen that with subscription, we think advertising is going to follow a similar pace. It's also kind of addressing a consumer proposition of a great kind of set of entertainment across film and TV and ultimately games titles at an accessible point for consumers. So that's also great as well.

But then the key for us is like with that, how are we going to it into a really big business- So we have sort of stepping back 2 big priorities. One, we have to scale the reach of our ads tiers. So we need -- advertisers want a scaled solution. So that is the #1 priority.

And then #2 is to better monetize that reach. So we have the kind of benefit of scarcity today, but we want to create less scarcity by driving a lot more reach than -- we know we can deliver engagement, we have to deliver regions here. And then, obviously, better monetize through the combination of kind of capabilities and go-to-market resources. So the -- how we do those 2 things and address those 2 priorities become very much -- very much tactics. And it's a lot of tactics that we layer on over time.

Starting to see it -- if we use reach as an example, it started with just improving feature set, right- So we started with what was basically a feature set that looked like our basic ads-free tier. And then we improved video quality, we added streams, we achieved content parity. So that's kind of a piece of the puzzle.

But over time, then we -- as part of rolling out paid sharing, that was another reach driver, because some of those folks that spin off, spin off into advertising accounts. And there's a bunch of other tactics that will continue. So assume that, that is a big priority for us, is to kind of drive that reach and scale. And then, of course, we'll continue to kind of build out our monetization capabilities.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Okay. So Microsoft obviously helped you get off the ground like incredibly quickly, the best probably anyone's ever kind of taken an ad platform to market. But what capabilities do you still need to build out internally to drive your own internal advertising capabilities-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes. Well, sure, yes, it is something that we kind of think about both ourselves and Microsoft. I mean this is a partnership. As in all partnerships, we're always pushing ourselves to be better and do more. And collectively, we're trying to build a really big and successful ads business.

And part of that is, as you say, things -- first of all, we both have to do a lot more, but then there's a share of things that we have to do in terms of our own internal capabilities. It's -- and it's like better targeting and relevance capabilities on our end, measurement capabilities. And a big part of it is just the go-to-market. So sales force and sales support and really kind of supplementing Microsoft's capabilities in market.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Right. So despite having 2 powerful of these -- you're word, ARM, not ARPU, but you're 2 powerful ARM drivers password sharing crackdown and your advertising build-out. And even though you have a password sharing and advertising, your guidance for Q3 was flat to down year-over-year ARM. Can you just walk us the drivers impacting the third quarter ARM and how that will change coming into the fourth quarter and beyond-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes, sure. So there -- when we think about, yes, ARM average revenue per member, sorry, for those who love ARPU, but it's -- on our ARM, average revenue per member. We guided to kind of on an FX-neutral basis, flat to slightly down in Q3 similar to Q2. And the dynamics you see there, if you kind of break it apart, that we've got some things that work in our favor and some that don't in terms -- so starting with the don't or the headwinds, it's things like when you think about the member growth that's coming for our service, 90% plus of that growth is outside of the U.S., and the U.S. is our highest ARM market.

So there's a kind of a country or region mix that's going to be a slight drag on ARM. And as an example, APAC has been our largest growth region in our lowest ARM region. So that's one natural thing that's -- that will continue to happen as we continue to do that. That will always be a little bit of drag on ARM.

The second thing is, while our plan mix is quite stable across tiers, whether it's premium, standard, et cetera, while we're going through this kind of early rollout of paid sharing, if you think about the nature of it, folks are spinning off into their accounts. Some of those folks were for affordability and other reasons on the premium tier. So there's a little bit of a move out of premium and to others. This is a slight relative to historical. So that's a little bit of a drag.

And then we also -- we do have some ancillary revenues that run through our business that are small today like consumer products, sometimes we have events and other things. And there were some dynamics from Q2 of last year to Q2 of this year and same with Q3 and Q3. I think last year, we had like Netflix Is A Joke or something in Q3 of last year. These are small things.

This is like noise in the system typically. And offsetting that, we have the benefit on ARM of extra member. So that's starting to build, but it's not that significant yet in terms of our overall member base, right- You can -- as we say, if you just do the math, we had 5.9 million paid net ads in Q2. And of that, we also said we have a pretty good mix between kind of spin-off accounts in extra member, but a little bit in favor of spin-off accounts.

So not all of our net ads were because of paid sharing to begin with. And then if you think about a subset of that extra member, it's just not a huge amount of extra members to drive ARM yet. And we said ads, which is also a driver of ARM. It's just not that material yet. So those things kind of cancel each other out, but they're just -- they're generally noise in the system that you wouldn't see.

The real story is that we haven't been increasing pricing since early 2022, and we've lapped price increases. So that's kind of what you're seeing in the ARM trends in both Q2 last quarter and what we guided to for Q3, because the main action we're taking to accelerate revenue growth this year is the rollout of paid sharing. And the way paid sharing shows up initially is bringing in more paid members, which is not an ARM driver, it's a paid member driver, which shows up in revenue acceleration.

Over time, as we guided to in Q4, we expect to have kind of revenue continue to accelerate, but it's not -- I just want to manage expectations, it's still not a major ARM story this year in '23. It's not going to be in Q4 either. Not giving you specific guidance, but we really have to get back to what is more balanced kind of revenue growth in '24 and beyond through a combination of continuing to grow our membership.

Our pricing philosophy has not changed. You can assume over time that's action we'll continue to take as we deliver more value to our members. And ads will -- if we do our job well, we will continue to grow in materiality, and that will contribute to ARM, too. So again, our primary -- our North Star is growing revenue, but ARM will be a piece of the puzzle going forward in '24 and beyond.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

So with the near-term impact of password sharing and I'd say maybe the medium-term impact of ads, how are you thinking about the longer term growth opportunity for Netflix-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

So long-term growth opportunity for us, I'm super bullish on our long-term growth opportunity. I think for us, the opportunity to grow the business is it's -- I would start with the fact that we think we're starting in a really good position. So we're starting in a leadership position in terms of revenue, profit and engagement.

Just to put that in perspective, you see the revenue and profit relative to kind of industry profitability, at least in streaming profitability. And in engagement, just fun facts, I guess. So in the first 28 weeks of this year, we had the #1 streaming TV series, 27 of those 28 weeks which Nielsen reported in the U.S. and the #1 film 24 of those 28 weeks. So we are, by far, a leader in engagement as well.

I think when Nielsen reported their -- for their top 10 that they report in 2022, we had 5x the engagement of our nearest competitor in terms of view hours in the top 10 and 3x of all of our competitors combined. So engagement is a key barometer of kind of health and future growth of our business because from engagement, it's -- that is really a proxy for member satisfaction, enjoy and then also it kind of drives key metrics like retention.

So with that starting point, and the question is like, okay, it's a good starting point, but how do we grow from there and what are opportunities to grow- And like on every measure, and you've heard this from me, Jessica, it sounds boring, but on every measure, we see opportunity to grow. So whether it is like the shift from linear to streaming, when you think about view share, we're less than 10% view share in every market in which we operate.

And streaming is still sub-40% of the overall TV viewing in all those markets. In many markets, it's still in the 10%, 15%. In the U.S., it's almost at 40%. So there's still that secular shift to streaming and our ability to grow our view share. We look at kind of consumer spend or industry spend in the markets in which we operate in, it's over $600 billion globally, would add a little over $30 billion of revenue last year or about 5% of that addressable revenue market. So we're small there as well.

And then in terms of kind of household penetration or TV penetration, we talked about it before, there's about 500 we estimate smart TV or connected TV households around the world. We're only in about kind of 240 million on a paid basis. So we've got another kind of doubling of that by addressing paid sharing and then folks that aren't enjoying Netflix today and that market is going to continue to grow and get penetrated.

So to do all that stuff, what we're focused on is to grow into those big markets, we have to improve every aspect of our service. So that's why we're so focused on improving content, improving the product, improving marketing and better monetizing all of that engagement.

And it starts with content, right, because that's what our members care about most. So we think we've built up a pretty durable and growing competitive strength in that it's really kind of tough to do those things well, because it means being great at commissioning and developing content in all these countries around the world with different languages, cultures, tastes, affinities, wrapping technology around it, user interface and discovery, payment system, collecting payments, all these places around the world, driving the zeitgeist and conversations.

So most companies are pretty good at one or two of these things, we're really good at one or two of these things. We think we're pretty good at all of them, and we just need to keep getting better. And if we do that and stay focused on it, we think we can continue to drive more and more of that entertainment value and build a really big business.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

So most or some, but maybe most of your competitors or streaming services have recently announced price increases. Do you view -- the price increases by your competitors, like does that give you confidence to raise price- Or conversely, is it an opportunity to be an even bigger share gainer-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Well, we -- I think it's good for the industry generally that folks are, I would say, pricing a bit more appropriately to the value that they're delivering, right, as opposed to just subsidizing and giving away the product, but we really don't price to our competitors. Our pricing philosophy is unchanged.

We start with delivering amazing entertainment, amazing TV, amazing film and increasingly, hopefully, amazing games to our members at scale, delivering more and more value and then pricing into it. And for us, it's about being more sophisticated in how we monetize that entertainment value, that engagement and ultimately building that kind of widespread in price options to both address at one end, really accessible access -- great accessibility into Netflix with a great feature set.

You've seen us do more of that in the past 12 months. We've lowered prices in many countries around the world where initially, when we were in global, it was sort of a skim strategy. It wasn't super sophisticated and we were overpriced in a lot of these smaller countries, small percentage of revenue, less than 5% of our revenue. It was over 100 countries where we drop prices.

We also launched the ad tier now in these 12 markets. So these are ways to kind of create more accessibility for Netflix and ultimately grow and optimize revenue.

And on the other end of the spectrum, we want more and more ways to kind of and price into fandoms. So I think you'll see us continue to get more sophisticated and kind of widen our pricing opportunities while also maintaining a level of simplicity, so it's not confusing in terms of the ways people are enjoying Netflix.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Right. Both password sharing and advertising are extremely high margin revenue sources. Can you help us think through the incremental margin associated with these revenue streams-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Well, yes, they are high-margin businesses. They're not 100% margin businesses. But yes, we believe they're high incremental margin. Paid sharing is a little bit more like pricing and member growth in terms of less -- fewer direct costs associated with it. Obviously, there's people costs and things behind the scenes.

Advertising has some more direct costs in terms of building out sales force. There's revenue share, there's tech stack to build out. There's capabilities there. But both -- we wouldn't be getting into these if we didn't think they were big, both revenue and profit contributors to the business. But we don't really parse it individually like that.

To be frank, we manage to kind of a global P&L and overall margin. So to me, that's what we should best have an eye towards. And what we're trying to do is build these businesses in a way that, yes, they will be meaningful margin contributors and help us as we accelerate revenue with which both paid sharing and advertising are intended to help us accelerate and sustain healthy revenue growth.

And then with that, to start ticking up our operating margins, again, our kind of -- our reported operating margins, which peaked to 21%. We've been managing in the 18% to 20% range roughly. But this year, it's already starting to tick up from last year. We ended at 17.8%. We're guiding to 18% to 20%, so the midpoint of that range is from last year and will start to tick up again going forward.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

And could you help us think through like margin expansion over the next few years-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes. It's -- so when we -- the way we think about building operating margin and every company has the right to their own philosophy, but ours has always been that it's best to kind of grow our operating margins while we're growing revenue, right- So it's just easier to build that profit muscle as we're growing revenue. So if we really step back, when we went global, fully global back in 2016, we ran the business almost to breakeven as we built out that global launch. But then we started ticking up margin about we said roughly 3 percentage points each year. So we went from 4% operating margin, and we ticked it up all the way to 21% in 2021.

If we kind of look forward now, as I said, our priority is to get -- is to accelerate revenue growth. And as we do that and to start ticking up margins again, we said we're starting to do that this year and we would expect to do that going forward in '24 and beyond. But we want to balance it with being able to invest in all that big growth opportunity, the big prize that we were just talking about in terms of those big addressable markets.

So we want to have a balance. So I don't think given our scale now that we're at roughly 20% operating margins, I don't think it's really prudent for us to keep growing at 3 percentage points of margin per year. I think that would probably constrain the business too much on the growth opportunity. So we'll grow margins more gradually.

At some point, there's probably some peak margin where it's a good balance between peak margin and growth potential of the business. I just don't think we're anywhere near that yet. So we're going to gradually go into it. You've got -- we've got a bunch of benchmarks. You know them as well as I do, of networks at scale that are well above 20% operating margins. So we think we've got a lot of headroom. We just want to grow into it in a healthy way.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

But can you help us think to where do you think the natural peak margin in the business is-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

I don't know have a specific number for you other than it's well above where it is today. I mean you've seen businesses that are kind of -- I mean, you know these numbers. There's always these networks -- and the legacy network historically, they were fully distributed 100 million households. And so we think we have some inherent advantages in terms of the business we're in today because our distribution scale is so much larger than that.

We're already at 240 million, so we have a truly global network that's going to grow from where it is today with content that is designed to have big, local impact but be able to then travel and success regionally or globally. So it's a good scalable content model. So we hope to kind of grow at levels that networks have been at before, but I'm not going to give you a specific number.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Networks, meaning like cable networks-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

I'm not going to give you a specific number, Jessica...

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Okay. Those margins [were] 50%.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

I'm not -- I know you want a number. I'm not giving you a number.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

It's okay. We have a lot to cover, so let's keep going. So it's almost unavoidable, but we have to just at least touch on the strikes. What is the impact on Netflix on the dual strikes in terms of both content and if we include the content strategy in that and also your financials-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes. We talked about the financial impact or estimated financial impact on the last earnings call. I think really kind of cutting through it, though, the main thing -- and we try to stay focused on the main thing in Netflix. And the main thing is that there's a lot of folks at work, and the business isn't moving forward. And so it's terrible for all those folks that are in work and it's not good for the business. So that's what we're most focused on.

I mean at the end of the day, to move the business forward and to have great storytelling and fresh stories for our members, it really is about partnership with those writers, with those producers, with those directors, with those actors. And so we need that partnership to be healthy. We need to get back to work. That's what we're focused on. And so suffice to say, we are very committed to get back as quickly as possible. In the meantime, we're managing.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Okay. So moving on, you mentioned gaming a few times. And even though you've been in the gaming area for, I don't know, several years now, it still feels like a developing business. Can you talk about your plans and long-term aspirations in gaming and how much investment is needed-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes, sure. So yes, it is -- I mean, it's definitely a developing business. We're almost 2 years into it. I don't know -- I don't remember exactly when our 2-year anniversary is, but we're right around it. And when we launched games, we said, hey, this is a long-term growth opportunity for us in success. It's a giant adjacency. Half the world is some form of game -- playing games or a gamer. So it's a giant market, both in terms of users, in terms of pick your kind of revenue number.

So in success, we think it's a big growth opportunity for us. But we started out in terms of our commitment, we started out first on mobile because it's the way for us to get into it faster in terms of development cycles. So fast forward to now 2 years in, we've had about 70 games on our service. It's a range of games from licensed games to games that are now just starting to come out from -- we have 6 studios, so we had to -- both -- we grew studios organically, but we also acquired a few along the way to get us started.

And so now you're seeing games on service that are a range of both those licenses as well as internally developed, a range of IP from some bigger third-party IP to new IP like OXENFREE II, which just came out -- came out recently. But also things like Too Hot To Handle and Queen's Gambit and some things around our intellectual property of increasing mix of live services and not just kind of playthrough games.

But it's still early for us. So ultimately, our vision is to have games that are playable across multiple services, not just mobile. You see us starting to do that a little bit with some early forays into being able to play on the TVs as well as mobile.

But really, right now, we're just kind of building our learnings in this business in terms of what works. You see us kind of building out more games with Netflix IP as an intellectual property as an example. And we're spending in a way that is like material but not material to the business yet. So this is not a dip our toe in the water and like we're going to get out. This is we're in games for the long term. It's a relatively small percentage of our overall content budget today, but it's still on an absolute basis, a pretty meaningful set of dollars in order to really go after this adjacency for us in this big new content category.

And then like we've done with other content categories as we build confidence in the -- we've already seen at smaller scale, the ability for this to be a benefit to the business in terms of driving things like retention and kind of core metrics, we need to prove it out a bigger scale. And then what we've done in the past with other content categories is then we kind of ramp up our investment, and we can do that pretty quickly.

But this is a -- think of it as we said early days when we launched, this is not a material driver to the business in the next -- when we launched, we said in 3, 4 years. This is something that's a 5- to 10-year kind of growth impact because that's -- we're still on that trajectory.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

And sports -- obviously, you guys get this question all the time. What is your long-term goal- Is it sports-focused entertainment and documentaries- Or is it something else-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Well, we love sports, and it's a big viewing category, right- So we're just -- what you've seen us to date is like how can we participate in sports in a way that is also good for the business in terms of impact on both member satisfaction but also return on investment. And so we've been doing that in areas that are much more kind of sports lifestyle programming to date. I think we've done a nice job from Drive to Survive to more and more of that with Quarterback and Living with the Furys (sic) [At Home With The Furys] and Full Swing and a bunch of others I'm forgetting right now.

But -- so we're, I think, becoming a great destination for those sorts of stories around sports and compelling lifestyle stories that are really adjacencies and kind of sports adjacent. It's good for the leagues, it's good for our business.

Whether or not we get into kind of direct licensing of sports, it's not like we're anti doing that. It's just it's hard for us to see that as the best return on what really would be billions of dollars of incremental content investment. And so we see a long runway in the areas that we're playing in right now. And it's really hard to do the things we're doing today across film and TV and games all around the world, right- So that focus is one of our advantages.

It's good, frankly, that there are some pretty big streaming competitors that are going more and more into sports because it builds that secular trend of the transition from linear to streaming. It's an accelerator of that, which is a good thing for our business. But with a lot of things, we say never say never, but it's not something that we found a way to have kind of a big revenue and profit pool from being a license...

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Another area -- sorry to interrupt, but another area that you guys have gotten into recently is live content. Can you talk about like what have you learned- What's interesting to you- Does the advertising capability have an impact on what kind of content you're looking for in live-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

It's not driven by ad capabilities. It's really about can we further -- can we do things that further amp up and making it an even better TV or title experience, if you will. So is there a way to create more of an event around some of our programming, and that's what you've seen a little bit with whether it's reunion shows or other types of events that we have done or are looking at. So I would look at it as, hey, it's a proven form of entertainment. It's not like live is really a new thing. It's new for us, but can we do it in a way that's additive to our entertainment experience.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity

Research

Okay. Last question because we only have a couple of minutes. But your balance sheet is incredibly strong and very liquid. And you're generating -- I mean, I would say explosive free cash flow from where you were. There are several distressed media assets that are likely to be for sale, maybe not publicly announced, but should be for sale. Can you talk about what your appetite is to be a potential consolidator of IP or studio assets- And I guess the last part of that question would be, any thoughts on capital returns-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Sure. So I mean we've been historically more of a builder than a buyer. We had done -- we did about $2 billion of M&A over the last couple of years, but that was in areas that we believe could accelerate our business, whether it's in game studios as we talked about or IP driven like the Roald Dahl Story Company.

But we -- as you say, you mentioned distressed assets, yes, we have a strong balance sheet, but then it's about how do we best drive the growth in our business in a healthy way. We think that kind of focus and simplicity has been a good thing for us. If we purchase those distress -- I mean, one, it's a high bar for M&A in general for us. We said we're more kind of builders versus buyers. And a distressed asset probably has an even higher bar in a way because of the risk of distraction. I mean -- and most of those are legacy entertainment assets that as we see every day, there's very difficult and challenging transitions that go along with that.

So yes, we look at everything. We keep an open mind, but I would just say it's a very -- it would be a very high bar that to be something that we entertain. And in the meantime, we think we've got a really long runway of organic growth that we stay focused, which then gets to our balance sheet.

Our capital allocation policy is unchanged, which has been pretty consistent in the last few years which is great.

We first invest in all the core areas of growth of the business. We invest as much as we can into funding that growth and things like ads, games, et cetera and our core content and service offering. We then opportunistically look at M&A and then we return excess cash to shareholders. That excess cash is -- we hold about 2 months of revenue, which is roughly $6 billion.

So we've been a little bit high on that lately. So we said we ramp up our share repurchase in the back half of the year. And we'll probably continue with that kind of a share repurchase program for returning excess cash as opposed to things like dividends. We like the flexibility of share repurchase.

Jessica Jean Reif Ehrlich Cohen BofA Securities, Research Division - Managing Director in Equity Research

Great. Thank you so much for coming here. Thank you.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Thank you, Jessica. All right. Thanks, everybody.