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Corporate Participants

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

Conference Call Participants

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Presentation

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

All right. Great. If everyone can please take the seats, we'll get going. My name is John Hodulik, I'm the media and telecom analyst here at UBS, and I'm very pleased to announce our next speaker is Ted Sarandos, the Co-CEO and Chief Content Officer at Netflix. Ted, thanks for being here.

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

I'm glad to be here.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

So we've got about 40 minutes for Q&A. I've got a list of questions to go through, I also have the

iPad here. So anybody who wants to use the app and log in some questions, I'll work them into the conversation.

Questions and Answers

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

So first, Ted, as we always do here in this late in the year, can you give us a sense of Netflix's sort of priorities as we look out into 2023.

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

Yes. So look, we're like most companies, happy to get '22 behind. We've -- for prior -- and whereas in '23 are to reaccelerate revenue growth. And so you look at it at the business and how we've done going into this and we've gotten into -- the first half of the year was pretty good bumpy for sure, kind of unprecedented levels of competition in terms of -- and certainly super subsidized competition.

And [Indiscernible] the economy with FX, with all those things. So we're coming out of the year, putting a lot of that behind us and with a real solid plan to reaccelerate revenue growth. Launch, I'd say is one of the things I'm super proud of as an organization is in those challenges at the beginning of the year.

This company, which has built an incredible culture, had incredible strength to regroup and not get distracted and to keep building. And I think about things like in 6 months, we built this ad product from scratch. Our COO, Greg Peters, just attacked this as a challenge to do what is widely viewed as impossible was to build this ad product and get it up and running. It's up and running and delivering ads.

Now we're not patting ourselves on back too hard, it works. It delivers advertising, but this is definitely kind of crawl-walk run. And it gave me a lot of confidence in the organization that this organization can rally and regroup, which we did.

Similarly, on the content side, the team kept focus. They stayed at the course. This year, in these very tough conditions, we launched 5 of our most watched shows in the history of Netflix in 2022 and 3 of our most watched films in the history of Netflix in 2022. So we're super excited about the future. We've got a good plan to reaccelerate revenue growth. And we have got this very fortunate position, which is while our competitors are reinventing themselves pretty radically. We get to do exactly what we're doing, just a little bit better every day and stay at the course.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Great. That's a great overview. And I've got a couple of high-level questions before we drill -- and drill down into some of those growth initiatives, we may touch on the ad here. So first, just -- and this is a question we get a lot. And you sort of touched on it, given all the competition that we're seeing. I mean just how good of a business is streaming. I mean how can investors get confident that this is a good business-

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

Well, look, first of all, it's, if you believe that people still want to watch TV and watch movies and play games, it's a good business. And how you monetize and how you grow it is important. And this is something we've been doing for a long time and have done, and we do it profitably. So I get why people are puzzled at the migration of the -- from linear TV to streaming, how everyone is going to do it, but we're not making that migration. We are in the streaming business. We are profitably in the

streaming business.

This is a \$5 billion, \$6 billion business for us, and it's growing. So as long as you are convinced that streaming is going to keep growing. And linear, some of our -- one of our very high-profile competitors, there's a lot of skin in the game on linear, just said, linear television is on the crest of going off the cliff.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

And, frankly, I have heard that today, earlier today and yesterday, too. I mean whether its cord cutting or even the ad market, I mean things are not great and...

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

Yes. So you believe that streaming is going to be the way that people consume content over the next 20, 30, 40 years. Remember, prior to streaming, cable television, pay-TV had 50 years of growth before Netflix. So we're in the early days. We're about 10% of what people spend their time on television today. So we have plenty of room to grow, and streaming is going to continue to be the way that people mostly watch movies, watch television and play games.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right. And then, along with that, long-term margins, how can we get comfortable with what the long-term margins are in this space as the company sort of matures and you expand the offering and expand into these new geographies-

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

Well, prior to the current headwinds, remember, we were expanding margins every quarter. So every year. So we're looking at -- we'll get back to -- back on track, I think, over there once we get through some of these quite temporary conditions.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Got you. And does competition play a role in that- I mean, one of the -- and again, we've explored that with a couple of companies today. I mean, is there too much content being made and is there too much competition in the space right now-

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

I think if you look at it in the kind of old media sense and say is there more -- there's a lot more content being made today than there used to be. But it's not all for you. So really, the idea is that we've been doing very successfully, and like I said, profitably, is delivering a really broad, diverse slate of content. We're bringing out something new pretty much every day on Netflix.

The multiple titles, multiple movies, multiple series and across every discipline of television. From original Japanese anime in Japan, Mexican novelas out of our Mexico group, our animated series, animated features, big-budget [beast] action movies, everything you want to watch, we're making. And I think it's a really important thing to do when you're trying to basically entertain and add value to members.

It's very difficult, I think, to have any kind of ability to extract value from consumers unless they are experiencing it. So the core KPIs in this business are very simple: engagement, revenue and profit. So for some reason, when we talk about this business, we get clouded with a bunch of other things like Rotten Tomatoes scores and raw subscriber numbers without any ARPU attached to it. And it's

not really a good way to measure the business. I would measure engagement, profit and revenue.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Yes. So lastly on competition. I mean, obviously, a lot of competitions in the U.S., I would say, similar to [Indiscernible] in a lot of markets around the world. I mean do you think we're at sort of peak competition- Do you expect any sort of consolidation, maybe rationalization of the spend within the competitors or even some consolidation-

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

If you look at -- it's hard to say, like a lot of the -- what is subscale and what isn't in this market- You guys have to determine that. For us, we really focus on our core business, we've got our hands full with running our core business. And I look at this and say, "Look, I'm glad, one thing we've never done in our business is take our P&L below zero."

We've built a business that is cash flow positive. So we don't have to go to market for funding and continue to grow it. And I think when you look at the conditions of growth and what it's going to take to grow from where the competitors sit today in terms of just size and scale and hours of engagement of those products. They've all got a lot of running room. They've got a lot of room to go to catch up to us. And we have to keep growing, we have to keep expanding on it.

At no point do we ever say, okay, that's good. We're going to close from here. That's why we go through like something like Wednesday, that came out last week is, it's chasing Squid Game right now to be one of the most watch shows in the world. And again, what gets really cool about these things is that while we're getting better and better and making original content from all over the world, like Squid Game was this big wind because it was a South Korean show that people lost all

over the world, including the U.S., especially in the U.S. even.

And now you've got Wednesday, which is a top 3 show in Korea, India, Japan, all the places that really have a preference for local content. So we're strengthening both our ability to make global content but are even better doing it from just about anywhere. And I think having that emphasis on the local market helps us tremendously and then being able to pick those projects that are global, but not by preconceived definitions global, not big the old from America, and we're going to make it big everywhere else. It's going to be storytelling from anywhere to everywhere, which gives us a lot more variety of storytelling.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Got it. So lastly on competition. How do you see competition from casual and nonprofessionally-produced content on platforms like YouTube, TikTok, reels and others- Is that a -- do you see that as a competitor- And do you need a platform that sort of caters to that-

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

I don't necessarily see it as a competitor. I obviously pay a lot of attention to because it's how people spend time. What's been fascinating is as people spend time on TikTok by way of example, what that really does is that they actually use TikTok to express their fandom, which actually grows their affinity for content on Netflix. So the hours have spent on engagement, if you think about it, the way that people get excited about Wednesday early on and started talking about it, they started posting music videos. And they started making their own content based on their excitement about how much they love Wednesday, which grew Wednesday tremendously.

So it's not that they're -- certainly, they're a competitor for time, but they're also an incredible

marketing platform, and we have to get better and better leveraging to build on that fandom. So if you think about the impact of the music business that Netflix has today, I mean these are kind of zeitgeist data points. But if you think about like Wednesday with all the success on Netflix, has grown 2 songs particularly. There's Lady Gaga song from 2011 Bloody Mary and Goo Goo Muck from The Cramps. I'm a guy who like the music of the 80s. It's great that my kids now know The Cramps but that's -- a lot of that is Netflix and Tiktok that people making those videos and getting them rolling in those 2 songs, those songs are up on Spotify 9,500% in a week, it's phenomenal.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

You did the same with Stranger Things like kids were listening to that song for...

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

Kate Bush, Running Up That Hill, it's #1. It didn't do that, 37 years ago, didn't even get to the top 25 and now it gets -- hits #1 of the chart a week after Stranger Things came out.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

You should charge some sort of promotion fee or something.

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

Well, it does tell you though, that the value -- that's what I talked about is why engagement is so important. It happened because hundreds of millions of people watch the show and having the platform, having that ability to engage a global audience that fast and then create this whole [zicas] around it. There's not -- and by the way, it's not just music.

When The Queen's Gambit was out the sale of chessboard went through the roof. So if you think about things like that, the ability to impact the [zicas], I can't -- I don't know of. I have not heard of any of those things happening on other platforms yet. Maybe they will, but I have not seen it yet.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right. So let's switch to content. And as you look out into 2023, can you talk about some of the projects that you're excited about- You mentioned Wednesday as a sort of a recent hit, but are there others that sort of excite you-

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

Yes. Look, I think for 10 years, we have been -- we built an original content organization that has been running really fast. And we had to do in 10 years, where all of our competitors had 100 years of experience doing, creating IP and building on stories in television and film world.

We started from scratch. In that 10 years, we built a library that has generated more watching revenue and profit than all the other libraries in the distributor space. Super proud of that. Right now, I think we look at a lot of these projects and saying, now what do we do in the next 10 years- We get better at development. We get better at world building and franchise building.

Before the end of this year, you're going to see Blood Origin, which is a prequel origin story to The Witcher, which is fantastic. You also get a third season of Emily in Paris, a piece of IP that didn't really exist in the world until a couple until 2 years ago. And then I think on the 23rd of December, you have Glass Onion, which I think is a real step function in our film space.

So when I talk about the growth in television and that 10-year run and the very fact that 5 of our

most watch shows came out this year, that's such a testimony to Bela Bajaria and that television team that they're being able to grow upon and build upon success. And similarly, with Scott Stuber in the film group. Glass Onion: A Knives Out Mystery is , I think, a culmination of a lot of hard work, we've been at the movie space only for a couple of years, like we're on our fifth year of original film. And we've been at the Oscars every year and [Indiscernible] which is nice.

But really what we're after is exactly what you're going to see on December 23, a movie like Glass Onion, that is universally loved by the critics and wildly commercial, but fans really love this film. And they'll be able to all see it on the 23rd of December, and you'll see what we're talking about. But I'm trying -- we're trying to make content that fans love first and foremost. And if critics love it, too, that's great. And if it wins awards too, that's even better but start with the fans.

And like I said, that film team has been very focused on that and Scott and his team have been really great at doing that, and I think Glass Onion is a great example.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

I have some British friends that are excited about Harry & Meghan, which I think...

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

Harry & Meghan, I should have mentioned that, yes, December 8, some people are talking about it right now, as we speak.

Yes. very excited about that, too.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

So again, within the budget, first of all, is \$17 billion the right number for content spend- And what can you do within that [Indiscernible] to improve the product and sort of reaccelerate growth that you talked about-

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

Look, I don't know if it's precisely the right number, but it's in the right ballpark, it's in the right neighborhood. And I think if you look at it right now in that model today, some certain segments of our content groups are growing, and we're shifting it around to where they find this use of the money.

And the key for me is not that you have to spend more and more money, but its that, can you get more impact per million dollar spend than anybody else- And you do that by making great content that people care about. You do that by having great relationships with creators that are focused on the audience and making sure that the content you're making is connecting with the audience.

And I think our ability to do that is so much better today than it was 10 years ago, and we've done pretty well for the -- in the first 10 years. So I'm pretty excited about having all of that \$17 billion to spend with 10 years of experience behind us today. And I can see it in every year, every quarter, where the content becomes more and more impactful all the time. And we're not trying just to constantly beat ourselves. We're trying to be the best in the market. I think at the end of the day, you have to have the content that people love.

And even more than that, the steady cadence of hit delivery that we've done, even this year, if you look at it since Stranger Things Season 4 and then followed with Dahmer -- Monster: The Jeffrey Dahmer Story into Watcher or into Purple Hearts and now into Wednesday. And these -- so it's

beyond people just thinking, hey, I love what I'm watching.

They have to also have an expectation. They're going to love what's next. And that to me is being able to build on that steady out -- smooth out the release slate. It's been really lumpy, particularly since COVID because everything shut down at this -- one thing that he ever happens in storytelling world is the entire world shut down at the same time. so that all these films got backed up and then delivered at the same time, and then people's avails got all tripped up on each other. So I think next year and the year after, you're going to see a much smoother release schedule as well. So the hits will come more steadily.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

And as you look for growth, especially more outside the U.S. than inside the U.S., do you shift some of the budget from U.S. produced content into more locally produced content-

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

Well, that's been happening organically as it goes. And like I said, the beauty is if you can get the art form right, their locally produced content can play [big] all over the world. So it's not just the America to supplying the world content. The Empress from Germany is a great example that played all over the world for us recently, Extraordinary Attorney Woo from Korea and another Korea success that also played all over the world, including in the U.S.

So this cadence of international watching for us, it keeps doubling in the U.S. because people really have discovered storytelling from around the world the way that makes those moves when we move \$1 from the English language to non-English production, that it can have a lot of impact.

Right now, the #1 movie on Netflix is a Norwegian movie called Troll, that people are loving everywhere, including in Japan, Korea and India again.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

I mean if we can get to the geographic area. I mean, you have such a lower penetration in some of these markets, APAC, EMEA, I mean, are those areas of sort of specific focus in terms of generating content that you think- I mean, obviously, you listed some of the content from these areas, and obviously, a lot of this plays globally, but is that -- is it sort of an extra focus to try to drive penetration and some growth in those areas-

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

Yes. First and foremost, we want those local productions to be hugely impactful in the local territory. And if they're really great, they travel. So that's the nice windfall of doing it right. And in some cases, the biggest example, that's obviously like a Squid Game. So but the chances are, what's really different, the dynamic that Netflix has proven out that nobody else has ever proven out is that it's almost as -- not just that it's possible, but it's almost equally likely that we make a great show anywhere in the world, they could break out all over the world.

That's really never been done before. And even thinking about ways like how confident are these local teams getting. This year, we produced the German entry for the Academy Awards, all quiet on the Western front, which has also been a nice commercial success for us, too. And Bardo, which is the Mexican entry for the Academy Award. I don't know that any single production companies ever done it from 2 different countries in the world. So that's pretty cool, right-

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Any other sort of genres or areas where you feel like you need to ramp investment within that \$17 billion envelope.

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

No, I think it's a constant adjustment. It's constantly turning dials up and down and looking for places who are places where they're doing it better than others. So a lot of times, I think the local taste is determined by the history of distribution in that country versus some kind of genetic predisposition to like or not like things. So I think people's habits are developed by what they could -- what they had access to before.

So the reason why no one used to watch non-English-speaking content in the U.S. is we've had an embarrassment of riches of English-speaking content. And so now I think people are looking at this thinking, what are the chances that I was going to be watching new content from Korea. Now I'd say pretty high.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

And now they're probably -- like you said, they're more willing to check out a Korean show or Norwegian show.

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

And the idea that these folks can be global stars -- that originating on Netflix, that is something that we offer the creative community that nobody else does. And what I mentioned about the hits to the -- music hits and all those things, think about the level of star creation that has happened from Netflix that has not happened anywhere else. And if you get outside of the U.S., it's almost

impossible to happen.

We often see some of the biggest stars in Bollywood to be completely unknown outside of India. And versus now, I think when we have a big hit show in India, that person is recognized at the [LAX].

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right. So sports. Obviously, you're standing up the ad tier. Is advertising capabilities the first step into getting you guys into sports. And I say that because we're seeing this against the backdrop of Amazon investing more heavily in sports, Apple and other platforms, putting more in sport, either simulcasting or putting new original or sports right on their platform.

If you don't head down that avenue, is it a disadvantage for you-

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

Look, today, renting big sports, we've not seen a profit path to renting big sports today. Not to say there never will be, I'd say, in today's -- the economic models that are built around that are built around the economics of Bay Television and different on streaming. So I'm just trying to figure -- if we could figure out a path that renting big-league sports would be neutral to slightly -- even slightly more, but it's dramatically more expensive, I think, in terms of watching. It's very popular. I definitely agree. I just -- we've not figured out. We are not anti-sports for just pro profit.

And we've been able yet to figure out how to do it. And I am very confident that we can get twice as big as we -- without sports. And then beyond that, maybe we'll have to figure out -- maybe by that time, maybe the economics change, or we have the scale to figure that out or something.

But today, I'd say we did a really thing that's kind of unheard of in television -- in the history of television is we've built an enormous audience. Imagine you had 165 million households. So maybe twice that in terms of people watch Squid Game without having to premier it after the Super Bowl, right-

We didn't have -- we didn't need a big loss leader to build a big audience. And if we can keep doing that, maybe that is our structural advantage to linear television.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

And with sports. So when you say -- you said renting sports, right- So the idea, and I think you guys have said this before, if you figure out a way to sort of own those sports like F1, which was one opportunity. That would be something you could...

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

Yes. And if you think that we've had a big impact on music, look at the impact Netflix has had on Formula 1. So that should be able to translate, but in this case, if you create the value, it just transfers into higher prices for licensing down the road.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right. And what about other live programming- You have Chris Rock coming in early '23. Is this sort of a test of sort of live events- And could it see you move into live events sort of more fundamentally over the next couple of years-

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

Yes. We did a lot of the plumbing work on live over the last couple of years already. So the technology was there for us. We just hadn't really tested it out. And I think about it for us is things that are creatively benefited by live, like live of the event like Presto's big -- his concert or the results show of one of our competition shows, those kind of things are actually a lot more fun to watch live. So we built the ability to do it.

And technically, there's nothing really novel about live television. We should be able to do that. So this is the way I'd say it's mostly creatively driven versus trying to open up other kinds of programming. That's how to make the program that we do today, a little more fun when it's live.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Got you. Okay. Shifting to advertising. Obviously, early days of the ad tier. How important is advertising to the growth of the company over the next 5 years-

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

Look, it's growing. And for us, we -- we've always talked about our company as a choice company. We really care about consumer choice, and which we do. And over the years, we -- one bit of consumer choice we didn't offer was, what about if you are not price -- if you are very price sensitive and not very -- an ad tolerant, very ad tolerant.

So there's a lot of folks, my son included, who say, Netflix had priced for that. I'll take that. That seems like a good idea. Because I think you watch an ad to watch a 30-second video on YouTube, it's generation on that way. So for him, I'd say, and there are people like him that will do that. So I would say that it opens the market up to us to that demographic that we've not been appealing to

before, which is, again, kind of looking for they'll take the lower price and they don't mind ads. So it opens market in that way.

It gives some optionality as we focus on the other piece of our revenue expansion, which will be the kind of the paid sharing, which to give those folks another option as they get into -- as they come under their own Netflix account. So in no way -- but other than that, I'd say that advertising for us is crawl, walk, run. We're definitely crawl right now. We just got -- we just turned it on and it works. Thanks. Great.

It will become important as it grows because I think it's a way that people will pay with attention versus a credit card. And this is a way of expanding the offering to our members. And the more choice we have given in the past, ultimately, it has been market expanding. So we think this will be, too.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Got it. So can you give us a -- is there a road map you could talk about -- to talk about how the product will evolve over time- And I guess the first part would be, do you expect to launch other ad tiers of other tiers that you guys have now, instead of just the basic tier-

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

So we have multiple tiers today. So it's likely there'll be multiple ad tiers over time, but nothing to talk about yet. And the product itself will evolve. I suspect pretty dramatically, but slowly and gradually in that -- the things that we will hope to bring to advertisers in the future is a better mousetrap. How do we serve your advertising in a way that people could respond to it better- How is it more -- and a more elegant solution for consumers and advertisers.

I think today, there's a lot of frustration with ad buyers with streaming services, delivery of advertising only because [Indiscernible] dramatically better than television was. And I think as they look at -- as eyeballs shift, can they have a better experience on streaming with advertising. It can be delivered elegantly in a way that is better suited to what they're watching or what time of day they're watching or would be -- when they -- could we put on a multipart ad because we know exactly which part you've seen already all those kind of things that I think we can toy around with and we'll be better and better.

But our goal is we want to deliver a product that is amazing for advertisers and great for consumers. And so we have to do both of those things, and we've always kind of echoing what Reed said last week because they fit perfectly with the 2 things we care about the most, which is happy consumers and growing profits. You have to do both -- whatever we do, we have to do both of those.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Makes sense. Should we expect the ad load to grow over time or even ad formats to change over time-

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

From today- Yes. So it definitely is a work in progress still.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Yes. So as you go through this process, I mean, how do you make sure that it's not disruptive to the member experience-

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

Well, as you know, we're an entertainment company with deep tech route. So we do a lot -- we test, we [Indiscernible] test everything. So a lot of the things that we try to do, we get out to, and because we're a pretty global footprint ex China, we can get out there and test different markets in different territories and make sure that what we're doing is positive for consumers and positive for the business.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Have you guys made progress in reworking the content deals so that they allow ads. You had a sort of a tale of third-party content-

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

Yes. Yes, look, it's pretty small. We're nearly about 90% of watching is covered in the ad tier today, and there's much of legacy content in there that those deals whether flow off or get renegotiated over time. you should expect near -- not complete parity, but the near parity over time, but it's not -- definitely not necessary.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Got it. So last quarter, you guys mentioned that churn remains slightly elevated. Should the ad tier help lower churn- I mean, as you guys look at -- you said it increases the TAM effectively. I mean did it happen through lower churn and a bigger funnel, more people coming in- And how would you weight those...

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

Yes, we could. I mean, basically, as I think about it as the ad tiers a lot or the paid sharing, the ad tier gives a place for paid sharing to land. You think about potential for a softer landing for folks either who are paying for the first time or for who are looking, who are -- have some economic strain today.

So I think it gives more optionality. And every time we have added more optionality works. I think the other thing that's interesting is that when people join Netflix, whatever tier they join, they tend to stick around in. So we don't think we're going to see a bunch of a lot of migration in the plans. Most because they're satisfied with the product that they joined for.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Got you. And what about cannibalization of so you said that people aren't going to shift down from the higher tier but even I mean you expect a lot of existing sort basic tier.

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

Yes. If there's organic demand for the product with that, we want to be able to serve that. It's not good for us, I think to jam folks into a situation not happy with it all. We definitely have a happy member business.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Yes. And over time, I mean, you guys sort of laid out that you thought the ARPUs would be sort of similar, how you sort of came up with a \$3 discount. But if you run the math on potential CPMs and ad load and all the engagement, which you have, which is dramatically better than any of the other

platforms we cover. I mean there's the potential for it to be significantly higher than the \$3, the ad ARPU.

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

There is potential for sure.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

I mean obviously you've got to get the mousetrap right, you need all the targeting, but I mean is it -- are we right in thinking you could be sort of multiples of that \$3 that you choose.

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

Look, there's possible large upside in that for sure, but I would look at it and say, the way you grow advertising revenue is by either -- if you think about it in the CPM universe, you either grow CPMs or just grow Ms. So right now, we've got a lot of eyeballs to watch Netflix, and if they watch in the ad tier that it will grow Ms without -- and then the other one is the better and better you get at the product itself. You can grow CPMs as well.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right. And I think and I don't know if you guys said this on your guys -- with your guys video. But I mean, I think we all take a -- certainly, my team, we take a very U.S.-centric view to the ad market. I mean, it can...

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

Look, a big chunk of the TV ad market is the U.S.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right, right. And it's a much -- very high CPM, I mean -- do you see this as being a big factor driving penetration in these underpenetrated markets like EMEA and APAC- Or is it...

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

It's possible. Good ad markets are also good Netflix market. So the socioeconomic -- the socioeconomic conditions exist for Netflix to be successful in either tier, either with ads or without.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Yes. But if you had to say the U.S. market is, is it -- is it sort of half of the upside that you expect from the ad tier or...

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

I think for most global ad companies, that's about the math.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Okay. Got it. Sounds good. And lastly on add tier, just how should we think the margins for the ad tier sort of versus overall margins- Is there much of a difference- I know you have third party, you have the deal with Microsoft-

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

I definitely shouldn't be beyond the selling cost, there's not -- the hard cost is content that's already

spent. So there shouldn't be a lot of additional costs associated with the ad revenue. It should be relatively high margin.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Got you. Okay. Let's shift briefly here to paid sharing, which will begin rolling out in early '23. Any other detail you can tell us in terms of, maybe you had tests in Latin America, sort of what the learning -- main takeaways there and when we should expect you guys to move forward-

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

Yes. Look, here's the good news. The paid sharing model is the folks who use -- who we're talking about here, all use Netflix. I'll love Netflix. I watch Netflix for hours. So it's really now going back in and saying, now you may have been on your ex's password, it's time to get your own account, and we're going to create some easy -- the easy soft landing for them to do that.

I would say in all those testing that we've been doing around world, it feels a lot like the way you manage a price increase. So it's really -- it's revenue positive and it should be market expanding. So when we look at it, and no mistake, I don't think consumers are going to love it, right out of the gate. And obviously, we've got to land in a way that they will, and they'll see the value in Netflix so much so that they're happy to have their own account.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right. I mean, I guess when you say it's like a price increase. So I guess, first of all, it must take the place of another pricing piece that your sort of organic price increase that you were going to do half -- I guess it gets pushed out, it takes the place of another price-

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

That's -- I mean we -- look, this will be a big focus for us in '23. And in some places, it will be in place of another places, it will be in addition to just try to navigate it. It won't, theoretically, won't touch a lot of the same people.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right, right. That makes sense. And then is there any way for us to sort of measure or sort of forecast the churn you're going to see from this one. Obviously, it's going to -- to a certain extent, depending on how it's implemented, depending on the magnitude of price increase. But just...

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

Again, back to engagement revenue and profit, is it revenue growth- Is it profit- Does it increase profits- That's what I think is the best way to focus on it.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Yes. And unless they...

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

And getting back to just like a price increase, that don't make anyone that happy. But they see tremendous value. And we've always forward invested in value before we went to a per price increase. And I think in this case, you're talking about forward investing in value for this addressable base. These are folks who are enjoying Netflix literally for phrase today.

So if they're getting a lot of value out of it, I think they'll be happy to have their own account.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

This is a personal question. How do you sort of prevent disruption from a sort of a hypothetical user who has 2 kids in college, who -- they use the service.

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

So here's, interesting -- back, like I said, we kind of ignored doing the advertising market for too long, probably.

This is another one. I think when we look back at it is we created a product that was not very easy for you and your kids, too, if you wanted to, to pay. So unfortunately, I think that this is addressing some of that, too, which is to say, my kid's going off to college, and now he's going to -- he may have his own account, when they go to college.

So I just think it's -- again, it's -- if you look at the hours of engagement on Netflix, and the unbelievably low cost of a Netflix subscription, right- It's probably the cheapest thing you can do for your kids is get him a Netflix subscription.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

We're going to purchase the ad tier for sure, the ad tiers for them. And maybe with the time left, we have just the strategy as it relates to video games. And you talked about crawl, walk, run on the ad space. And I think you've said you've used sort of similar wording in terms of video games. Which developed faster- Does the ad tier sort of start to have an impact faster than the video game market-

Or is -- what you're doing in video games-

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

Well, they're both pretty long-term initiatives. So we're in the early stages of both as well. We're a little probably or longer into the games by much. And the core is I think the way you think about video games is I think in 10 years from today, consumers are going to spend a lot of time and money watching movies, watching TV shows and playing games.

I'm not exactly sure what the proportion will be, and it will probably be very different for each consumer. And today, we're barely in the game part. We just got into the game business. And I think it will be important, I think, for the next decade of to be part of that entertainment package. And can we better monetize gaming through the subscription model, the way that we did for TV and film.

So we're in the early, earliest days of that investment. This again was Greg Peters, our COO, who's been phenomenally engaged in some light M&A, building that team, a great leader in that group called -- named, Mike Verdu, who is super accomplished in the gaming industry and being able to kind of integrate these game publishers and game developers into Netflix has been really fast in anything. And they'll move fast, and we'll do both.

So the key is like we're doing these at the same time, the same way we kind of added film to television and international to domestic and made those migrations. You have to be able to walk and [Indiscernible] at the same time.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Right. And the engagement and although everything you've seen from the gaming strategy. Has that

played out as you expected-

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

Early but promising, early but promising.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

And are there more -- like you said you bought a couple of smaller publishers or there's a lot of these guys out there. A lot of them are having -- spent on the mobile side having problems with IDFA things like that. I mean, it seems like that would be a good opportunity to...

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

It's an amazing opportunity to be able to reach a lot of people and made in an incredible way that mobile gaming -- or in the early days and as it evolves, how to reach these big audiences and have big cultural impact. It's been pretty hit and miss, I think, for the game industry. And I think for us, like you'll see coming up for us, we have new games coming out in the Stranger Things world across a bunch of our IP, even our Nailed It baking competition again based in there.

So the ability to expand our IP universes in games will be incredible. But just as incredible will be developing games that will [Indiscernible] movies and television shows, too.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Makes sense. And then lastly for me. M&A, we were just talking about M&A in the video game space. I mean you haven't done any sort of large-scale acquisitions. I mean especially with what we're seeing in the media ecosystem and all the fallouts I'd say over the last 2 days seems to maybe

be a little bit worse than what we thought. I mean, there may be some opportunities for you guys to buy some assets that could sort of add to your franchise. I mean what's your overall philosophy on M&A- I mean -- and do you see that as a way to sort of improve the product and sort of achieve some of the goals [Indiscernible]-

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

So we've historically been builders, not buyers. I think that's been true of everything that we've moved ourselves into. In the last couple of years, though, we did some acquisition around Scanline, a great VFX company, Animal Logic, a great animation company, companies like Night School in the game space. So we've done some light M&A over the last couple of years, and it's gone well for us in terms of integration. Those have been -- the things that are most exciting for me is that we ever looked at something on the road.

We mostly think about it as in the IP, things that are attractive in the IP space. But like we did the Dahl Story Company a couple of years ago. But I think right today is we're historically we're builders versus buyers. So I think we'll probably lean on that for a while.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

That's great. Well, that's great way we end it. Ted, thanks for being here.

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

Thank you.

John Christopher Hodulik UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Appreciate it. Thank you.