

Netflix, Inc., Q1 2023 Pre Recorded Earnings Call, Apr 18, 2023

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Corporate Participants

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Spencer Wang Netflix, Inc. - Vice President of Finance, Corporate Development & Investor Relations

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

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

Conference Call Participants

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

Presentation

Spencer Wang Netflix, Inc. - Vice President of Finance, Corporate Development & Investor Relations

Hello, and welcome to the Netflix Q1 2023 Earnings Interview. I'm Spencer Wang, VP of Finance, IR and Corporate Development. Joining me today are co-CEOs, Ted Sarandos and Greg Peters; and CFO, Spence Neumann. Our interviewer this quarter is Jessica Reif Ehrlich.

And as a reminder, we will be making forward-looking statements and actual results may vary.

With that, Jessica, I'm going to turn it over to you for your first question.

Questions and Answers

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

So let's start with Ted and Greg. You've worked together for over 15 years, but this is your first quarter as co-CEOs. Are there any highlights you want to share-

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

Well, Jessica, as you pointed out, it's our first quarter together as co-CEOs but 15 years working together. And in those 15 years, you build a lot of respect and trusting each other to help you get you through some trying times. And not to let you down about there's no drama, but this was pretty much a business-as-usual quarter for us, having done this together for so long.

And Greg and I enjoy the same kind of trust, respect and shorthand that I enjoyed with Reed for so many years. I know that Greg did as well. So it's not as eventful as folks might have thought, and it's really been incredibly and wonderfully professionally stimulating to have a co-CEO, to get to tackle big problems together. So I think one of the things that we'll look back at Reed's incredible 25 years at Netflix, one of the great accomplishments, is facilitating this very, very smooth transition and succession.

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

Great. So you've recently reduced prices in 116 countries. Is this a more local approach similar to what you did in India in 2021 or is the impetus to enable a successful introduction of password

sharing and advertising tiers-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

I can take this one, if you want, Jessica. This is really about, we talked for the last few quarters about further refining our pricing strategy and monetization. And if you think back to when we did our global launch in 2016, it was pretty much across the board, a bit of a skim approach and not particularly sophisticated in terms of our pricing. So think of this as kind of that next step in our evolution of a bit of a better market fit, product market fit, pricing fit, with the aim of growing our penetration in these markets and also better medium and long-term revenue. So better for our members, better for our business.

But just want to emphasize, this is not a material to our business anytime in the near term, for sure. So it's a lot of countries but it represents less than 5% of our revenue. And so it's something that will, over the long term, hopefully, will benefit us. And we can point to an example of success as sort of like what we saw in India. So last year back in December of '21, we dropped prices in India between 20% to 60%. We saw engagement over the past year grow by about 30%, high growth in paid net adds. And also revenue, FX-neutral revenue growth actually accelerated from 19% in the year prior to 24% last year. So that's -- we're not saying every market is going to play out like that but that's what it would look like in success.

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

Great. Let's move on to password sharing. What have you seen in your Q1 new market launches, churn as well as conversion- And can you give us any specific color on what you've seen in Canada, whether it's in terms of new subs versus add-ons-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes. I'll take that one. So this is an important transition for us, and so we're working hard to make sure that we do it well and as thoughtfully as we can. This last of the country rollouts have gone well, and maybe most importantly, were directionally consistent with what we saw in Latin America. So just to remind people what that looks like, it's very much like a price increase, we see an initial cancel reaction. And then we build out of that, both in terms of membership and revenue as borrowers sign up for their own Netflix accounts, and existing members purchase that extra member facility for folks that they want to share it with.

So first of all, it was a strong validation to see consistent results in these new countries because there are different market characteristics, different from each other and also different from the original Latin American rollout countries. So to get to a positive outcome, you mentioned Canada, we're now in a positive member and positive revenue position relative to pre-rollout. So that's a really strong confirmation that we've got an approach that we can apply in many different countries with different market characteristics, including our largest revenue countries.

In fact, we actually -- we could have launched that solution. We actually considered that option. But we also learned from this last set of launches about some improvements we can do, especially in areas that matter a lot to our members, things like having seamless access to Netflix as they've always been using it on the go or while traveling as well as making sure that we've got good tools for them to manage access to their accounts and their devices.

So all in, we felt, based on those results, it was better to take a little bit of extra time, incorporate those learnings and make this transition as smooth as possible as we can for members. And we think that approach also best serves the long-term business goals as well. So we're going to launch this new improved version broadly, including in the United States, in Q2.

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

So as a follow-up, so the cadence, you said the U.S. in Q2. How about the rest of the world- And is there -- can you give us your thoughts on pricing and whether you have a preference for a current borrower to become a subscriber or an add-on-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes. So that launch we're doing in Q2 is a very broad launch. It includes the United States, includes many, many other countries. I mean we reserve the right for some countries where we think there's a different approach, but I would say the bulk of our countries. And certainly, when you think about it from a revenue perspective, the vast majority will be rolling out in Q2.

You mentioned in terms of pricing, we'll look at that on a market-by-market basis. But obviously, we tested different pricing in these last rollouts that will be tested in Latin America. And that gives you a sense about how we're thinking about what is optimal pricing, especially in more affluent countries, so I'll leave it at that.

And then in terms of preference, what we're trying to do is create a structure that really supports choice. So that gives an opportunity for folks to spin off to borrower accounts where they think that's the right solution for them or for use cases, which are legitimate use cases, where somebody wants to basically buy Netflix for a family member or something like that, we want that extra member to be in place, too. So we don't really have, I'd say, a strong preference. We're not trying to steer in one perspective other than using pricing to both satisfy those customer choice goals as well as thinking about long-term revenue optimization.

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

Research

One more on password sharing, are there any incremental cost- It seems like content distribution, marketing are already in your expenses. So is the incremental margin 100%- Or are there plans to reinvest some of this revenue so it doesn't all flow through-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Well, I'll leave it to -- go ahead, Spencer. Do you want to take this one-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

No, go for it, Greg.

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

No, you got it.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

I was going to say there's really not -- other than just kind of just the general kind of allocation of resources, I wouldn't say there's real incremental costs. But of course, we always want to reinvest. So as you kind of see with our kind of guidance and our objectives generally, Jessica, we're looking to reaccelerate the revenue growth. That's the path that we're on right now.

And as we do that, we want to kind of balance, gradually increasing margins. You see that in our guide where we're looking to tick up margins a bit to the 18% to 20% range full year relative to just under 18% last year but balance that with that big prize ahead of us. So reinvesting to more and more great entertainment for our members and drive that flywheel of more entertainment, more value for members and, ultimately, more and more members over time and then build a really, really

big and profitable business.

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

So let's move on to advertising. Netflix appears to have a huge advantage in, let's call it, television advertising. I mean you pretty much have nothing to lose from a legacy perspective and everything to gain on an AVOD platform. Given the limited ad load, premium video content, your humongous reach and engagement with some pretty hard-to-reach demographics as well as the ongoing mass transition from linear to streaming, your position is enviable. Having said that, you seem to be very careful in your advertising rollout. Can you give us your key learnings to date and what the growing pains have been so far-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes. As you stated, we're significantly optimistic about the long-term opportunity, for the reasons that you mentioned. But we've always expected and we continue to expect, frankly, this to be a gradual build. It follows a very similar process that we've used in so many other areas where we get in, we learn as we go, we iterate. And we found that having that approach yields basically great long-term outcomes as we sort of grow and learn.

So I would say where we're at today, we've got a lot of work to do to develop -- continue to develop features that support advertisers. We're rolling out things like measurement and verification, but we've got a bigger, longer road map that we have to go do there. We're improving our go-to-market and sales capabilities in partnership with Microsoft. There's a lot of good work that we have to go do. And some of this is hard work. This is country by country. You've seen us add programmatic private marketplace that gives advertisers more ways to buy as we grow inventory.

And then we're also trying to improve things on the consumer-facing side. So we're adding more features to the ad plan. We're making that experience better for members. And through that sort of process, we expect those iterations, which we're trying to go as fast as we can on them while being judicious and thoughtful about the business, to really add up over a period of time into a significant, highly material and highly lucrative, high-margin business. But there's plenty to go do and we're trying to maintain a fast pace but also a thoughtful pace.

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

There've been a lot of press reports regarding your buildup of ad tech capabilities. Can you provide an overview of plans, time frame and cost-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes. I would say we have ambition to be innovative in this space. And a lot of that innovation is thinking about not a one-size-fits-all in terms of the member experience and thinking about what's the right time to flight an ad, things like that. But I would also say that we're very much in the mode right now where we're doing a lot of work that is following a well-trodden path to build a big business back to when you think about verification, measurement, et cetera, what we're doing on programmatic. Those are sort of, I'd say, relatively straightforward things. So a lot of the work that we're doing is really heavily in that space.

And then in terms of incremental costs, Spence, do you want to chime in here-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Sure. I'd say just generally, Jessica, we try to, in all of this, firstly, we've always -- we've talked about this crawl, walk around, which Greg mentioned, being very thoughtful and methodical on how we're

building the business and, with that also, how it impacts our overall financials, our revenue and our incremental profit contribution. And we believe we can do that in a very healthy way. So that's what we're building towards. So yes, there is some cost to this, both in terms of the cost of the Microsoft partnership and the cost to kind of some building out of our capabilities, people as well as tech capabilities, but all very manageable.

We also talked about a little bit of content costs as we continue to kind of -- we increased our level of content parity on the plan this past quarter, which is great. So it's about 95%-plus of viewing parity, which is, again, a great progress. So we're -- we keep moving forward, but this is all at a level that we believe is not just better for our members with a lower-priced option but better for our business. And we think we could do it, and are doing it, in a way that's, I would say, without being overly specific, think of it as like 50% or more incremental profit contribution to the business.

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

When you come to the May advertising upfront, which is in a couple of weeks, it sounds like you're coming with the standards here now. Do you have any plans to introduce it to your premium tier- And how much scale, meaning how many subs, do you expect on the platform when you roll out -- when the upfront commitments come in the fall, how much scale will you have-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes. So on your first question, we're always thinking about and working to improve that plan structure, the pricing. We've got 2 goals in mind when we do that. One is we want to give a wide range of consumers, and ideally, increasingly, wide range of consumers, access to our great stories at a range of prices with appropriate corresponding features. .

The second goal is think about optimizing long-term revenue. A good example of this is based on the economics of our ads plan, based on the limited switching behavior that we've seen off of standard and premium, we've upgraded the ads plan features, both in terms of video resolution or video quality and number of concurrent streams because we think it supports both of those goals. So that's a good example of that.

I would say beyond that, we've got -- we'll continue to evaluate as we always do. You've seen us make moves in the space before. But we've got nothing more to add on that today.

And then in terms of scale, obviously, we're growing. Every day we grow and we're seeking to continue to grow, but we're not going to sort of announce a target or what we expect, forecast, let's say, for upfronts at this point.

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

One more advertising question and then I'll move on. But can you provide ARPU specifics on what you've seen so far- Because you mentioned in the release that the revenue is actually higher than even standard. So it seems like so far, so good.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes, I can jump in. I mean, yes, overall, we're pleased with our kind of per member ad plan economics. It's higher than our basic plan overall. And as you say, in the U.S., it's actually even higher than our standard plan. So we really like the path we're on, the trajectory we have. And as I said, it's kind of a win-win because it's a lower-priced option for our members, and it's both kind of incremental revenue, incremental profit to -- for the business. So it makes the business stronger, which, of course, we can then reinvest into more and more great entertainment.

So we like the path. But again, it's early. We're only a couple of quarters into this, Jessica, so we're going to get better, as Greg said, better targeting and measurement, better kind of tools and buying options for advertisers. So we think all of that will actually kind of build on this so that we'll reinforce and strengthen that kind of premium CPM ad network that we're building.

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

So maybe switching gears a little bit to the capital returns and free cash flow. You did raise your free cash flow guidance, but you kept your margins the same for this year. What are your longer-term margin growth or expectations at this point- Pre-COVID, you had indicated 300 basis points of improvement per year over a few year period. Can you provide any update to that-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

We're not -- we've never provided a long-term guide to our margins. But I'd say we're already in a place where we feel great about the business that we have. It's a very -- it's a great business model. The business is at scale with over \$30 billion of revenue, healthy profit margins, growing margins, growing free cash flow. So that's sort of a starting point.

And as I mentioned before, we're trying to balance, as we reaccelerate revenue, ticking up those margins with also reinvesting back into the business, back into that member base, back into that big prize, where we feel like we're so small today. We've talked on recent earnings calls where we represent, we believe, roughly 5% of that direct consumer spend in the areas of entertainment that we're participating in today, primarily in film, TV and games.

And when we think about even just the member population that's available, those 1 billion-plus

broadband households, and even today, roughly 450 million, 500 million of those being connected TV households, and we only have 230 million-ish paying members today, roughly, right, so that's why we're so focused on addressing with paid sharing and then just making our business and our -- the value that we bring to the service better each day to bring in more members. So that's really what we're working towards.

And then long term, we just -- we don't see ourselves approaching a near-term ceiling. There's lots of proxies out there. Entertainment services and networks at scale traditionally have been well above our roughly 20% operating margin. So we believe we have a long way to go and we have some inherent advantages. We're a truly global entertainment network, perhaps the first, with really healthy leading engagement and a really scalable content model. So we believe we've got a long way to go but not really putting more specific guidance out for now.

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

Jessica, just if I could add an example of that, of the scale of the business being global, is that every one of our big content wins start as a local win. And then in success, they roll out and they get regional, then they reach as far, then they get global, and it's huge success. And there's no marginal cost to all that additional audience when we get it right.

So by driving -- creating those stories that drive growth of the business in local territories, it provides content into the pool that people can fall in love with, and it's just as likely that we can get a gigantic hit from anywhere in the world. And that's really the scale of our operating business. And to go back to what Spence said about the potential for -- to even grow margins beyond where we're at today is very, very high.

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

Could you give us an update on your capital return plans- I mean how are you thinking about -- you announced the 1.2 million buyback in Q1. But relative to your free cash flow and an incredible balance sheet, you have a lot of capacity. So can you give us any color on how you're thinking about capital returns over the longer term-

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

Sure. Spencer, do you want to take that one-

Spencer Wang Netflix, Inc. - Vice President of Finance, Corporate Development & Investor Relations

Yes, I can take that one. Thanks, Jessica, for the question. And we are happy to be fully investment-grade as of Q1. So that's a nice milestone for the company. And you're right, there's no change to our capital allocation philosophy. So we are still targeting to maintain minimum cash equivalent to roughly 2 months of revenue. Based on the Q1 numbers, it's about \$5.4 billion of minimum cash. We ended the quarter with about \$7.8 billion on the balance sheet, so we do have about \$2.4 billion of excess cash. So that is why we did indicate in the letter that our share repurchases will accelerate over the course of the year.

And then one other minor thing I forgot to mention in my intro, that this video interview will include forward-looking statements and actual results may vary. So I do want to say that, and here's evidence that this video interview is actually not scripted. So back to you, Jessica.

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

So Ted, how are you preparing for a potential writers' strike -- potential because it's likely-

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

Well, Jessica, firstly, I'd say, we respect the writers and we respect the WGA, and we couldn't be here without them. We don't want a strike. The last time there was a strike, it was devastating to creators. It was really hard in the industry. It was painful for local economies that support production and it was very, very, very bad for fans. So if there's a strike, and we want to work really hard to make sure we could find a fair and equitable deal so we can avoid one, but if there is one, we have a large base of upcoming shows and films from around the world that we could probably serve our members better than most.

And we really don't want this to happen, but we had to make plans for the worst. And so we do have a pretty robust slate of releases to take us into a long time. But just to be clear, we're at the table and we're going to try to get to an equitable solution so there isn't a strike.

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

And beyond the strike, just once you get past that, how do you expect content spending to change over the next few years- You've kind of been at the \$17 billion cadence. Does it depend on revenue growth- Can you give us some color on how you're thinking about that-

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

Well, yes, it depends on revenue growth. And also keep in mind that the way that revenue -- or the way that content spend hits us, it's with start of productions and deliveries. We still worked through or we came through or coming off of those post-COVID floodgates opening, and so that does throw -- makes the content spend a little lumpier. We expect to be back to about the \$17 billion level in '24. And the rate of growth depends on the rate of revenue growth, for sure.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Just to add to Ted's point because I totally agree with all of that and -- but again, it's -- there's a big opportunity ahead, so I just want to reinforce that. We're not going to -- we said we'd stay at roughly \$17 billion on average over a few year period, over that 2022 to '24 period, but there's a big entertainment market to go after beyond that. So as we reaccelerate revenue, we see a lot of opportunity to grow into that viewing and engagement and business opportunity ahead. So we expect to be there and we just have to build into it.

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

Absolutely.

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

Do you have any thoughts on revisiting your film strategy- In terms of like theatrical output as well as distribution, you've had so much success at the Academy Awards. So does that change anything for you- And you also recently had a restructuring in this division. Is there anything to read from that-

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

No. Jessica, the film division is doing great. They really are building some great films. As you pointed out, the success at the Oscars was great. But the thing even better than that was the movies that won so big were also very, very popular with fans. So this is award-winning, critically acclaimed and enormously popular with fans. Even, like I said, with All Quiet on the Western Front was that. Pinocchio certainly was that. And we're really proud of the films that were in the mix because they were loved by fans. So we're really happy with the investment in film. Of course, we're trying to improve it, like we do with all of our films.

But our release strategy, remember, there's a lot of ways to create and collect demand for a film. Driving folks to a theater is just not our business. We create that demand, we collect that demand on our subscription service with our members. And I think having big, new, desirable content, including feature films in the first window, drives value for our members and drives value to the business. So no major changes in play, except for trying to continue to improve the films for our members and make a big splash with films that are loved and watched.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

And it's really leaning into, we believe, an advantage we have of delivering that value to our members. But because of our reach and our scale, to have over 230 million paying members at our average revenue per member, it affords the opportunity to invest in these big movies, bring them to our members is just one other piece or area, a variety of content and must-watch content and entertainment for our members. So it's really kind of leaning into that advantage.

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

And I think it's tempting to make the comparison between the services, but the other services don't have that scale, as you pointed out, Spence. They don't have the revenue base or the viewer base to support with a single window the way we can support even big-budget films with a single window on Netflix.

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

How is your live strategy evolving- And Chris Rock was a huge hit, but Love Is Blind had some technical issues. Is live a big advertising driver- Do you need to invest more to beef up your technical capabilities-

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

Greg, do you want to grab that-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes, I'll kick it off. I would start by saying we're really sorry to have disappointed so many people. We didn't meet the standard that we expect of ourselves to serve our members. And just to be clear, from a technical perspective, we've got the infrastructure. We had just a bug that we introduced. Actually, when we implemented some changes to try and improve live streaming performance after the last live broadcast, Chris Rock in March, and we just didn't see this bug in internal testing because it only became apparent once we have put sort of multiple systems interacting with each other under the load of millions of people trying to watch Love Is Blind.

So we hate it when these things happen, but we'll learn from it and we'll get better. And we do have the fundamental infrastructure that we need. And I would say the good news is that, ultimately, 6.5 million viewers watched and enjoyed the show. Then I'll turn it over to Ted to talk about more of the strategy side.

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

Yes. Look, we've said we want to use live when it makes sense creatively, when it helps the content itself. So a reunion show that's going to generate news and buzz, it really does play better live when people can enjoy it together. Certainly, the Chris Rock standup show played out so well because so much anticipation for what he's going to say in that set. So when we have the opportunities to do projects like that, we like the fact that we have the option to do it.

As Greg said, we are super disappointed to not be able to come across with the live product for

everyone who wanted it on Love Is Blind Reunion. But we're super thrilled that people love the show. And it does point to the kind of love for that brand and for the growing love for those unscripted brands on Netflix. And some of them will be live. And I do think sometimes those results-oriented shows do play out a little bit better on live and they do generate a lot of conversation. But keep in mind, like on Chris Rock, about 90% of the viewing have been after. But it doesn't change the fact that it was a big event when it happened live.

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

Is it a big driver of the advertising-

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

We have no current -- go ahead, Greg.

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

No, go ahead, Ted. You take it.

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

I'll just say we do not currently have advertising in the live broadcast.

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

Right. I have one more question on password sharing, I'll just go back to that for a second. But of the 30 million U.S. and 100 million-plus global borrowers, that sounds like, from your release, that's actually the number of households. What is the number of potential subs or add-ons- I mean what is the potential conversion from these 100 million-plus households-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Well, to some degree, I mean, the borrowers, those borrowers that represent well-qualified people, in the sense that they have all the technical needs to get to Netflix, the smart TV, the broadband access, they know how the system works. They've clearly enjoyed content on the service before. So having said that, we see a sort of a range of engagement amongst those borrowers.

So some folks are watching as much of our shows as a normal paying account, and those folks have very strong likelihood to convert, I would say. And then we see that tail off -- taper off rather through that range of folks. And if you're watching much less, it's much less likely that you'll ultimately convert. But even in that case, I'd say this represents a really important structural shift where we'll develop that one-to-one relationship without pricing distortion, without membership distortion, with a whole new range of members. So we'll see membership grow through that approach. We'll see revenue grow through it as well.

But we'll also see a situation where in high viewer penetration markets, like the United States that you mentioned the stats there, some of those folks won't convert, but they'll represent essentially a pool of people that we can then go after with improving our offering, more amazing movies, Ted talked about that, more amazing series, more amazing games in the fullness of time, that will get those folks ultimately to convert over to members as well.

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

And then just also going back to like advertising, what are the advertising features that you are most excited about-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Well, again, we're sort of in this mode where there's -- what I'm super excited about it, and then there's the work that we really need to do for the business, which I'm also excited with that because it's just about how we get to be bigger. So there's sort of the brass tacks pieces, which are a lot about measurement: verification, targeting, expanding the ways for advertisers to buy. So I'm excited from a sort of immediacy of business returns for those pieces.

But then when you think about like from a technology and product experience perspective, what am I excited about there, that's again where I think we have an opportunity to bring the specific characteristics of a premium, fully addressable, fully targetable, fully deterministic ad streaming system to this world. And so that means that we can do a whole range of things in terms of how we flight creatives from brands associated with certain shows and things about how we tailor the user experience to be specific to what the user needs in a moment rather than having a one-size-fits-all set of rules in terms of how we flight ads.

So there's just a whole amazing line of innovation that we can go after, and we'll be going after for, frankly, for years. And we don't even know what all those things are because, mostly, we'll be working with advertisers and members to try things and then let -- then tell us what's working and what's not.

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

What do you consider the walk phase-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Well, I think we're sort of getting into the walk phase, and that's probably a combination of things.

One is scale. Obviously, scale is relevant in the business. So we're getting to a certain size of scale that shifts how advertisers think about us. Part of it is the technical features that advertisers -- that face advertisers. So that's very much along the lines of those measurement: verification, targeting the programmatic buying capability. That's a component of it. So those, I think, really constitutes -- I'd characterize that we're really -- we're basically getting into that middle phase of growth. And we've got a lot of work, frankly, to do in that before we get to the run phase.

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Yes. We talked about it's a multiyear build and a gradual build and crawl, walk, run. And we're only a couple of quarters into this. So I don't know, Greg, if you would agree, but I would hope we're in the walk phase by the end of the year and into next year. But I think this is a year of getting from crawl to walk.

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes. That sounds right.

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

And then I just wanted to clarify something, Spence. I think you said this is a 50% margin. I mean, typically, advertising could be as high as 80% or 85% margins. Is that -- do you expect to build up to that- Or do you think it's really just a 50%-plus business-

Spencer Adam Neumann Netflix, Inc. - Chief Financial Officer

Well, I put plus in there. So I said at least 50%, and it was really just to highlight the fact that we're still in start-up mode of this business and so leaning a little conservative. But yes, our expectations over time is that it would be meaningfully over 50%. But I don't want to give a specific number yet.

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

Okay. Moving on to gaming, can you give us some data points on engagement and what you're seeing on retention-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes, I'm not going to give you those specific points but let me just review sort of where we're at more broadly. We've got 55 games out to date. We've got 40 more in the queue for this year. There's very exciting games. If you want to try a few out, I'd recommend Terra Nil. That's a reverse city builder, sort of a twist on that genre. You've got Mighty Quest launching today. Our first new game from an internal studio, which is OXENFREE II, is coming later this year.

So you can sort of see it build into a combination of licensing and now layering in internally-developed games into that. And it's really -- it's following a trajectory that we've seen before, I would say, on these other new content categories that we've added if you think about film, and you heard folks here talk about sort of that film progress or nonfiction or international, where we sort of build into this over a multiyear period.

And to reinforce, you mentioned those metrics. I mean, the fundamental goal here, obviously, is to give our members a new entertainment modality and more ways to enjoy incredible universes and deepen their fandom. And we do that with an effort to drive the primary metrics we have on the consumer-facing side, which is engagement with the service, which leads to retention, and incredible stories that people are talking about, games that are must-play games, that create buzz off the service and motivate people to sign up.

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

Research

Are there plans to directly monetize games, for example, advertising or licensing IP to game developers-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Not currently. So we think that we're very consistent with what we've done in other parts of the business. The best thing for us to do is really focus on the core initiative, which, for us right now, is how do we bring games and games based on our IP to our members, to fans of that IP directly. And also, we believe that we want to have a differentiated gaming experience. And part of that is giving game creators the ability to think about building games purely from the perspective of player enjoyment and not having to worry about other forms of monetization, whether it be ads or in-game payment.

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

So maybe turning to India, which is one of the biggest global markets and one of the fastest-growing markets really in the world right now. Spence, you mentioned the pricing change in '21. And Ted, you recently said at a panel earlier in the year, I think you were in India, that it's your fastest growing market. And you've given the statistics engagement of 30%, revenue of 24%. But I think, Ted, you said that you're increasing your local originals from 28 last year. Can you just talk a little bit about this market- Like, what are your longer-term plans- Is it actually profitable- Or is this something that we -- where we can see a real change in contribution-

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

Look, I think what we've talked about earlier, when we get the pricing a little better, more suited to

the market, you can see that we can grow revenue and therefore -- and we grow engagement. We have to get the content that people just really flip out for. We've seen a steady improvement in that quarter-over-quarter, both in our films and our series. Rana Naidu now is a great show that we just -- that people are loving all over the country, and it causes a great deal of excitement for the service.

Now again, we got to get the pricing and the payment methods right. India is a big prize because it's an enormous population of entertainment-loving people and we've got to have the product that they love. And it's a product that they -- that you can do business with them together. So we've got -- we're doing the creative part and we're getting the pricing better, and there's always lots of promise to continue to grow in India.

It is a very specific market in terms of they like local content. But also you're seeing their local content is traveling more than ever. This was an incredible year. I think what you may be referring to, Jessica, that I was talking about, movies like RRR, which did business all over the world. And Gangubai was this really fantastic film that was in the hunt for the -- for Best Foreign Language feature. So you look at all these things and you say, well, that -- as the content opportunity continues to scale and our ability to access the market and as well those audiences continues to grow, we can do quite well in India. We're a long ways from that. We're still investing against it, and I think that we'll ultimately do great in India.

Spencer Wang Netflix, Inc. - Vice President of Finance, Corporate Development & Investor Relations

Jessica, we have time for 2 last questions, please.

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

Okay. So moving on to like accelerated revenue and products, can you give us an outlook or an update on -- just when you're seeing -- what your expectations are for consumer products- I mean you announced the Lacoste collaboration for clothing on your 8 most iconic shows. But you also have other collaborations. So I know -- it just seems like an area that, now that you're building up your own content, seems to provide incremental opportunity.

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

Yes. We continue to grow it. The primary driver for our consumer products business is to build and deepen fandom. It does drive some revenue. But in general, we're really looking for those opportunities to help fans connect with their favorite shows, their favorite films, their favorite talent, by wearing the shirt or carrying the notebook and other ways that people really like to express their fandom.

And also through these very successful live experiences, the Bridgerton experience or the Stranger Things experiences that travel around the world, we're super excited about all of them. And you see us stepping into even a newer one with the Stranger Things stage show. And there's all kinds of amazing stuff coming in that world. But keep in mind that it's mostly to build fandom in a way that can drive revenue but mostly it strengthens the core of the business.

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

Great. I guess one last one, so just a follow-up on password sharing. In the markets where you've rolled out password sharing, have you seen any movement between the tiers- Like, for example, a household that has a premium subscription, are they going to 2 standards or anything like that-

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

Yes. We see some of those effects, right- And we know that in especially price-sensitive markets, right, so this is also a situation which is very different market by market, but in some price-sensitive markets, consumers essentially got to a practical or informal pricing structure by subscribing to premium and then sharing us out and then, oftentimes, actually having people pay for a fraction of that from -- as they're sharing it.

So associated with that, we see some of that being shifted off of those plans and having those people sign up for individual plans as we rationalize that structure, implement the changes that prevent password sharing and also have them be able to use things like extra member or, in countries where it's relevant, the ads plan as a new entry-level price. I think you're going to see some of that sorting.

And again, we think this really -- it's better for the business, ultimately, it sets us up structurally to have more members, to have a one-to-one relationship with those members, to have all the systems that we have work more correctly, to have more transparent sort of pricing connections with those different members on the different plans. So we're excited about getting through that point. But again, I would characterize this as a very country-specific kind of approach where some countries respond that way and other countries really wasn't about that. It was much more about casual sharing.

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

And Jessica, if I could just add really quick, the way that we win over those sharers and the way that we grow the ad plan is to have the content that people cannot live without. And let me just tell you real quick before we get to the close here how we're doing on that front. Because this quarter alone, this past Q1, Night Agent became our sixth biggest original season of television in our history, incredible success.

We saw returning seasons of You for Season 4, a third season of Outer Banks, a second season of Ginny & Georgia, all shows that have grown from their original first seasons. And also shows that have created incredible new stars like Chase Stokes and Antonia Gentry and Madelyn Cline and Penn Badgley, who now have huge fan bases around the world. We saw The Glory, which is from Korea, our fourth biggest non-English launch ever. We had incredible big films with big stars, like You People, Your Place or Mine, Murder Mystery 2, did really well in the multi-cam comedy space with The '90s Show, and unscripted with Full Swing.

So this past quarter, we were super thrilled with the results of the content. And we have to keep that up in order to win over those sharing accounts and also to grow that ad-supported tier.

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

You missed Beef. You didn't say that. It's incredible.

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

I missed a bunch. Jessica, the reason why when we talk about our content, it sometimes sounds like a laundry list. It's a long list that really illustrates how hard this is to do, which is to hit on the quality and the breadth of the entertainment that people really want. And everyone has remarkably varied taste that you have to have very different things for different fans, and that's what we're good at doing at scale.

Gregory K. Peters Netflix, Inc. - Co-CEO & Director

And plus 1 to Beef. It's been an amazing time.

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

Well, that too. By the way, that's new this quarter, and it has kicked off. And it's having -- it's off to a tremendous start. And it's, again, another example of critical acclaim, likely to do well in awards season, we hope, but loved by fans.

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

Great. And with that...

Spencer Wang Netflix, Inc. - Vice President of Finance, Corporate Development & Investor Relations

Ted, did you want to take us home-

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

Yes. Just want to tell you real quick, we're really pleased with the quarter. 2023 is off to a good start. Netflix is the leading streaming service in terms of engagement, revenue and profits. And streaming is the future of entertainment at home. So on engagement, just yesterday, Nielsen released data that in Q1 of '23, Netflix was the most watched of any broadcaster or streamer in the U.S. by a pretty nice margin. We have -- and we have plenty of room to grow. Even with that tremendous amount of watching, we're about 10% of total TV time in our most established markets like the U.S. and the U.K.

On revenue and profit, we're growing, not as fast as we believe we can, not as fast as we'd want to, but we are growing and we are profitable. And we have a clear path to reaccelerate growth in both revenue and profit, and we're executing on it. You'll see a broader rollout of paid sharing in Q2 and we're going to continue to grow that ad business. And we also grow -- are aiming to continue to

grow free cash flow. As we said this year, we're going to generate about \$3.5 billion in free cash and on increased margins.

So remember that this account sharing initiative helps us have a larger base of potential paying members that we can continue to serve and grow Netflix long term, and that's why we've been so focused on execution. So the variety and quality of our much-watch movies, our must-watch TV shows, our must-play games, we're going to keep working to improve discovery, to have buzzier and more creative marketing because, when we deliver for our members, we deliver as a business. And we keep doing that by doing it just a bit better and a bit faster than our competition every month, every quarter and every year. Thanks, Jessica.