**Netflix, Inc. NasdaqGS:NFLX**

**FQ2 2020 Earnings Call Transcripts**

**Thursday, July 16, 2020 10:00 PM GMT**

S&P Global Market Intelligence Estimates

<table>
<thead>
<tr>
<th></th>
<th>-FQ2 2020-</th>
<th>-FQ3 2020-</th>
<th>-FY 2020-</th>
<th>-FY 2021-</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EPS Normalized</strong></td>
<td>1.83</td>
<td>1.59</td>
<td>▼(13.11 %)</td>
<td>1.99</td>
</tr>
<tr>
<td><strong>Revenue (mm)</strong></td>
<td>6083.43</td>
<td>6148.29</td>
<td>▲1.07</td>
<td>6398.13</td>
</tr>
</tbody>
</table>

Currency: USD
Consensus as of Jul-15-2020 10:06 PM GMT

---

**Stock Price [USD] vs. Volume [mm] with earnings surprise annotations**

<table>
<thead>
<tr>
<th></th>
<th>CONSENSUS</th>
<th>ACTUAL</th>
<th>SURPRISE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FQ3 2019</strong></td>
<td>1.05</td>
<td>1.47</td>
<td>▲40.00 %</td>
</tr>
<tr>
<td><strong>FQ4 2019</strong></td>
<td>0.52</td>
<td>1.30</td>
<td>▲150.00 %</td>
</tr>
<tr>
<td><strong>FQ1 2020</strong></td>
<td>1.64</td>
<td>1.57</td>
<td>▼3(4.27 %)</td>
</tr>
<tr>
<td><strong>FQ2 2020</strong></td>
<td>1.83</td>
<td>1.59</td>
<td>▼4(13.11 %)</td>
</tr>
</tbody>
</table>
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Call Participants</td>
<td>3</td>
</tr>
<tr>
<td>Presentation</td>
<td>4</td>
</tr>
<tr>
<td>Question and Answer</td>
<td>5</td>
</tr>
</tbody>
</table>
Call Participants

EXECUTIVES

Gregory K. Peters
COO & Chief Product Officer

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

Spencer Adam Neumann
Chief Financial Officer

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

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

ANALYSTS

Kannan Venkateshwar
Barclays Bank PLC, Research Division
Presentation

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

Good afternoon, and welcome to the Netflix Q2 2020 Earnings Interview. I'm Spencer Wang, VP of IR and Corporate Development. Joining me today are Co-CEOs, Reed Hastings and Ted Sarandos; COO, Greg Peters; and CFO, Spence Neumann. Our interviewer this quarter is Kannan Venkateshwar from Barclays Capital.

As a reminder, we'll be making forward-looking statements and actual results may vary. Now let me turn it over to Kannan for his first question.
Question and Answer

Kannan Venkateshwar  
Barclays Bank PLC, Research Division

Thank you, Spencer, and you nailed my last name. So congratulations for that.

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

I practiced.

Kannan Venkateshwar  
Barclays Bank PLC, Research Division

So thanks for having me here. And I guess the best place to start here is Ted and Greg, congratulations on your new role; and Reed, you too, I guess you can relax a little bit more.

So maybe we could just start off with your priorities, Ted, and maybe followed by Greg, just in terms of how you see the world evolving, what your priorities are. And of course, we are in the middle of a lot of change, so how you see the world. So maybe you could just start there.

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

Well, we should start by saying that the chances that Reed's going to relax a little more are very low, whereas I'm just -- everyone should know that Reed and I have worked together for more than 20 years. He's been an unbelievable role model and source of inspiration for me. We've navigated some of the toughest decisions the company has made over those years, from mailing DVDs around the U.S. to streaming around the world. And my focus is to continue the successful train we've been on for the next 200 million subs around the world. And Greg, I'm thrilled to throw it over to you.

Gregory K. Peters  
COO & Chief Product Officer

Thank you, Ted. From my perspective, when I think about what our future is and I think it's just a tremendous next stage of growth that we will see mostly coming from outside the United States. So think of more and more employees outside the United States, more productions, more operations happening outside the U.S. and hopefully, many, many more members outside the U.S. This is an opportunity to lean in just a little bit more, be proactive and drive a little bit more alignment across those activities where we think alignment will benefit the business and push the optimization of those activities a little bit more.

And Kannan, you might not know, but many years ago now it feels, I was able to spend a couple of years in Japan, launching the service there. And I got a chance to work with the local teams that we were hiring and growing there as well as our global teams to really look at every aspect of the service and try and improve it for our Japanese members and grow our membership base there. So I think of that as sort of like a mini version or a trial or a test out for what I anticipate I'll be doing more in this role.

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

And just as a small little fun fact for our listeners and shareholders who may not know, but Greg actually speaks 5 languages. So I think as we become more global service, that skill set will really benefit the company.

Gregory K. Peters  
COO & Chief Product Officer

Notice how he didn't say how well he speaks.
Wilmot Reed Hastings  
Co-Founder, Chairman, President & Co-CEO  

Are you talking Java, C++? So you mean like [indiscernible]. How do you find time, Greg, to do all that? It's pretty amazing. We are so excited about the next decade of Netflix growth. We've definitely got a good start, but the opportunity across the next decade is just amazing for us. It's a lot international, as Greg was referring, but I couldn't be more excited about it, and it will be great to have some help as we expand the globe, and I'm looking forward to that. And to be totally clear, I'm in for a decade. So let me be really clear on that. I'm in for a decade, okay. And as Co-CEO, it's 2 of us full time. It's not like a part-time deal. So it's definitely broadening the management team and helping us grow even faster over the next 10 years.

Kannan Venkateshwar  
Barclays Bank PLC, Research Division  

That's great. And so maybe, Reed, from your perspective, now that you have a relatively new setup, is there any kind of growth plans maybe that's out of the ordinary that you might be thinking about? I mean is Netflix in the next 10 years the same that -- compared to the Netflix in the last 10 years? So if you could just help us think through what your priorities are potentially now that you're sharing a job with Ted.

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

The 3 of us have been working together so long. There's essentially no difference next quarter. I mean, Ted's got some increased external stature, and he can put bigger deals together for us, and that's really cool. And Greg will start to spend more time around the world for us. But think of it as much more consistent with the past than different.

And then the beautiful thing about the next 10 years is we've got a good model. We just need to make it better. Every day, we work on making our service better, trying to make it so the billboard on the front of the UI, you could just click it and watch it and just like trust that result and then, of course, having amazing breadth of content, which we've been expanding. A couple of years ago, we only had a premium TV. And now to be really good in movies, to be really good in unscripted, emerging in animation, very strong in local language shows and series, I mean it's just -- it's incredible the expansion that Ted's pulled off over the last 5 years. So think of it as just us doing more of that at higher scale and pleasing more people, so no change in the focus or the execution and preparing for greater scale.

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

I feel like we have to make the shows and the films that people love and the stars that they want to spend more time with and being able to launch those brands, whatever your taste is all around the world, is such a monumental job, and I'm just thrilled that we have such a strong team to do it together.

Kannan Venkateshwar  
Barclays Bank PLC, Research Division  

That's great. And maybe we could just start with the environment we are in the middle of right now. Things seem to be -- seemed to be opening up but now, it looks like things might go back again a little bit. So when you think about the environment around you, a lot around us has changed, the way we work, the workflows around different organizations. So when you think about your plans for Netflix going forward, how has COVID impacted your plans? In what instances are these planned changes permanent? And can you actually benefit either from a cost perspective or a workload perspective in some ways that might be here to stay for much longer?

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

Do you want to start, Spence?
Spencer Adam Neumann  
*Chief Financial Officer*

Sure. I mean generally, Kannan, it doesn't change too much. I mean what we've learned is that the Internet, as Reed said even last quarter, we know that's a more important part of our lives and that's kind of here to stay, and also that people love film and television shows. So that -- our strategy is just to get better and better every day with that content, with that product, as we talked about. You can see in the business and we can talk about it here at some point. Obviously, we've seen some pull forward in our member growth, if you will, but frankly, our strategy hasn't fundamentally changed. There's things on the margin in terms of things around real estate strategy and how much content we acquire or commission in certain parts of the world. But fundamentally, our strategy remains the same and the growth opportunities as big as ever.

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

I could jump in on the production side. I mean it's been remarkable how nimble the teams have been to going from full-blown production to completely shut down to ramping back up all over the world in the space of a few months. I think some of the things, like the safety protocols that we're putting into place around the world, will become a permanent part of production, which is a good thing. I think this time in between the shutdown and ramping back up, the extra time that was spent on scripts and development and preparedness will make the shoots actually more efficient, which I think will stick around.

I think when it comes time to releasing the programming and the content to the world and working with the press on how we do that, we've done this remarkable virtual press junkets with our publicity teams that have put talent in front of the best writers in the world, almost uninterrupted just from their living room instead of a hotel room. And it's been -- the pickup and the efficiency of that, there's been some parts of that, I think, will probably last a long time. The different marketing functions, how you backfill not being able to host a screening, all of those things are being learned. And I think some of those things are going to be appropriate for certain content from today on and -- but I think we'll just be better and smarter, the way that we've come out of many tragic things in our history.

Gregory K. Peters  
*COO & Chief Product Officer*

And just to pile on to that, I think it's been an opportunity to accelerate things that we were already excited about. One, I think, great example is creating a sort of technical infrastructure that allows distributed content creators, artists, think about visual effects artists, animating artists to be effective when they're at home and collaborate collectively on assets. We think that was in the plans before this all happened. But it's the opportunity to accelerate that and make sure that we're incrementally more effective during this period has been great and we'll learn a bunch from it that I think will serve us quite well as we go back to a more normal working pattern.

Kannan Venkateshwar  
*Barclays Bank PLC, Research Division*

That's great. And when we look at the first half in terms of the subscriber numbers, obviously, you guys did close to the numbers that all of 2019 did. And so when you think about your guidance in that context, it does seem to embed an expectation of a lot of pull forward of growth. But over this period, we've also seen cord-cutting reach record levels, and that doesn't seem to be slowing down. And some parts of the world, again, seem to be shutting down right now. So if you could just help us think through the framework for growth for the next quarter and the guidance, that would be great.

Spencer Adam Neumann  
*Chief Financial Officer*

Sure. Let me take that one. I'll take it. So Kannan, you really nailed it. I mean when we think about the guidance for Q3, we're not thinking about Q3 just in and of itself. We have to look at it in the context of what just happened in Q2. And we just added 10 million members, which is the largest growth we've ever
had in a second quarter. And if you look at the -- so we kind of look at the totality across the Q2 and Q3 period. And if we look at that quarterly period, 2 quarters in a row, the best we've ever done in that period is actually 2 years ago in 2018, where we grew by 11.5 million numbers. So if we, this year, deliver on that Q3 guidance, that means we're growing 12.5 million members in that same time period, which is 1 million more than we've ever done, which is what we think big growth on top of what was already a very big Q1.

So the nice thing is that those newer members are actually highly engaged. They're sticking around with us actually as well or better than pre-COVID. And our service keeps getting better. So Netflix 2021 is going to be a much better service than Netflix 2020, which gives those newer members and existing members even more reason to stay highly engaged and stick around and also to entice future members to join. So we think that the growth opportunity is as big as ever. There's just that kind of near-term pull forward that you're seeing.

Kannan Venkateshwar
Barclays Bank PLC, Research Division

Okay. And when you think about other components of guidance, obviously, what stands out is the margin and the marketing spend as a proportion of revenues is 7%, which is obviously extraordinary new low. So when you think about -- and also the guidance with respect to content being more back-ended next year versus this year, that would suggest that as you go into the second half of this year and first half of next year, your marketing spend should continue to be lower than usual. So first of all, is that the right way to read it? And structurally, does this also mean that the amount you need to spend on marketing as a result of the kind of engagement growth is lower going forward?

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

Well, one of the things that's unique about our services, our members spend a lot of time on Netflix every day. So it turns out the best place to talk to them about Netflix is on Netflix. And our investment in time, energy and dollars goes into kind of building the conversation, the zeitgeist, the buzz around our shows and our stars and how do we make sure we amplify that even when you're not on Netflix. But in terms of the march towards less traditional media, we've been on that for some time, meaning that it's just a more efficient, more impactful and more global way to talk to our members is not through always through the most traditional channels. So yes, you're spending less but doing more to attract buzz and attention to our shows, trying to cut through a world where there's a lot of choices.

Spencer Adam Neumann
Chief Financial Officer

And maybe the only thing I'd just add is a little bit of what Ted touched on earlier, which is we assume marketing, in general, would be about flat this year, which is still about $2 billion of spend, which is a tremendous amount of spend across our marketing channels. But it does look like it will be lower because of some of those things we're seeing in this kind of new world in terms of more virtual junkets and PR and actually not doing as much awards, marketing and those sorts of things. Now some of that is temporary in nature. Some of that is permanent learnings as to how we can be more effective going forward. But I think you're right that as a result, it's -- most of this is just consistent with our strategic shift, and some of it is some near-term, I guess, cost/benefit from what's happening in the world.

Kannan Venkateshwar
Barclays Bank PLC, Research Division

Okay. And so when we think about...

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

We're seeing, Kannan, that the service has just been able to generate amazing viewing. And so as the service gets better and better, we're able to take advantage of that.
Kannan Venkateshwar  
*Barclays Bank PLC, Research Division*

Right. And when we think about your margin guidance for next year in that context, you have been improving margins about 300 basis points every year, but it looks like there is incremental opportunity now, but the guidance for next year is consistent more or less with the broader framework. So is that just conservativeness? Or is there something else guiding that as we go into next year?

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

Let’s call it tamping down the expectations. This is a great growth opportunity for us. So any revenue upside, we would tend to put into more content for our members, which generates more growth over time. So we’ve been pretty good about that, which is taking that upside and then converting it into more and more growth through service quality. So that would be the plan.

Spencer Adam Neumann  
*Chief Financial Officer*

Yes. And I would just say that we -- to Reed’s point, we’re always looking to spend strategically and invest strategically in the service. But we did signal that in the very near term, there may be some margin upside this year in 2020, but we’re really kind of trying to manage to that multiyear, continuing to increase our margins, which is why I wanted to let folks know that we’re, at this point, managing still to another 300 basis points increase next year, which would get us to that 19% margin.

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

And worth reiterating in an environment where Netflix 2021 is better than Netflix ‘20.

Spencer Adam Neumann  
*Chief Financial Officer*

Yes.

Kannan Venkateshwar  
*Barclays Bank PLC, Research Division*

That’s great. And so Ted, just to follow up on that comment, when you say it’s better in ‘21 versus ‘20, are we talking about subscribers? Are we talking about the amount of content? So how should we frame that?

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

I’m talking about the forward trajectory of the releasing of the content that's coming your way. I mean think about it right now at a time where most of the world is at a standstill. The rest of this month, you’re going to see from Netflix a brand-new series starring Katherine Langford from 13 Reasons Why called Cursed, a big, large-scale movie that kind of reimagines the King Arthur legend. We have a sequel to one of our biggest movies, Kissing Booth 2, the original that kind of birthed the rom-com movement on Netflix with Joey King and Jacob Elordi. We have a new season of Umbrella Academy, one of our most global and most successful series on Netflix that was a big hit for us when it came out in its first season in '19 and go rolling right into a big, high-octane action thriller named Project Power with Jamie Foxx and Joseph Gordon-Levitt.

So it’s that kind of ongoing beat of content and programming. Think about this. Last year, we had barely dabbled in competition and reality programming. This quarter alone, with Floor is Lava and Too Hot to Handle, we had 2 of our biggest hits ever in that -- not just in that genre but in our -- all of our programming. Too Hot to Handle, as a percentage of watching, was as big in Japan as it was in the U.S., which is a wild phenomenon. So that, to me, is all those learnings, they keep compounding and keep compounding and expanding across programming genres that make it a great value for consumers.
Kannan Venkateshwar  
*Barclays Bank PLC, Research Division*

That's great. So I guess sticking on that theme for a bit. When we think about the content mix, obviously, that's changed quite a bit over the last few years with reality shows and now animation and so on. So when you think about this particular mix, reality shows do seem to be a better return on investment in some ways because a lot of them have shown up, like Too Hot to Handle is in the top 10 list, was there for some time. So when you think about this mix, is it fair to think about reality shows or maybe documentary programming as being slightly better return and, therefore, the mix is shifting slightly more in favor of that? And is this even a framework that you consider, which is when you invest in something, what the returns are versus the engagement?

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

The big motivation to invest in reality and unscripted is not the cost savings of production, but the love that people have for this programming and how important it becomes in people's lives. So if we're trying to be more and more your go-to destination for entertainment, not to ignore an area of programming that kind of dominates broadcast, it would be silly of us. So we've been dabbling in unscripted reality. We kind of got very, very accomplished in the documentary space and then have moved that over and -- to expand that to unscripted. And then now the competition space, which -- this is only our -- it was only our third or fourth show really in the competition space that we've dabbled into. But the motivation really is consumer love for the programming, not the marginal cost savings.

Kannan Venkateshwar  
*Barclays Bank PLC, Research Division*

Okay. Got it. And Greg, just to think about the world from a distribution perspective, there's a lot going on right now in terms of disputes, the Peacock and HBO not getting carried on Roku. And of course, they're having problems with Amazon as well. So, when you think about this, I mean it almost feels like the legacy cable network MVPD disputes of the past where the aggregators are essentially becoming gatekeepers. How do you see this playing out? And is this a risk in the future for Netflix?

Gregory K. Peters  
*COO & Chief Product Officer*

First of all, I think it's just really unfortunate when those negotiations between a device manufacturer and an entertainment service provider get to this point where it really impacts consumers and they can't watch the shows that they're thrilled to watch on the device that they have. We've been lucky to be working, investing alongside, collaborating with a wide, wide range of device manufacturing partners around the world and really working together to create better Netflix experiences on those devices. And that's really a very positive model. It's really -- it's a win-win-win, right? It's great for us. We get to reach more of our members with better experiences. It's great for the device manufacturers because those experiences make those devices more valuable, more attractive. And most importantly and ultimately, it's a win for consumers to -- sort of the benefactors of those better experiences.

So we're going to keep investing in that model. We have whole teams that basically do nothing but work to make that whole process better, to make it easier for our manufacturing partners, to ingest the technology that we produce for those better experiences, to think about how do we leverage the qualities and features of the devices that those manufacturers are investing in their side to really show up those benefits. And I think we're hopeful and we expect that, that positive model will be able to continue.

Kannan Venkateshwar  
*Barclays Bank PLC, Research Division*

Okay. And then I guess the other model for distribution is just your deals with MVPDs as well as wireless companies, and you have a number of these deals globally. So when you think about mature markets like the U.S. versus the rest of the world, your guidance for next quarter as well as the broader growth framework would suggest that marginally, these become a bit more important than the organic growth
channels. So how are you thinking about these wholesale distribution deals? What kind of role do they have going forward? And what's the objective you're trying to solve for when you get into a deal with these guys?

**Gregory K. Peters**  
**COO & Chief Product Officer**

Yes. I think you have it right, which is that we think that these will grow in importance, but I think it's also important to note that they remain a relatively small percentage of our total acquisition and really what we call the organic channel. People signing up with us directly is still very much the dominant mode. But we sort of think about the criteria, which we sort of are evaluating these partnerships on 2 fronts. Obviously, we're looking at it as how much growth acceleration, how much membership acceleration do we get by adding a channel like that but then wanting to understand sort of what -- large are the revenue impacts, right? There's some cannibalization. There might be different economics involved. So we want to evaluate that and make sure that we're doing these on a positive revenue basis.

And then the other very important lens is we actually sort of look at it from what's the consumer experience, what's the member experience. And so we're looking at it qualitatively to sort of understanding what that member journey is and working with those partners to make sure that that's as positive, as friction-free as we possibly can. And then we all obviously back it up with the metrics, too, right? So we're looking at engagement and how frequently people use the service, churn characteristics to really make sure that we're delivering a high-quality experience to our members through those channels. And I would say that we're very positive on both of those fronts. And so to your point, we expect to continue to do these deals to expand these deals. We're working with multiple partners both in, to your point, territories that we're sort of further penetrated in, but it's also a great accelerant to territories that we're still in an earlier phase. And so we think both are great places to do that kind of partnership.

**Kannan Venkateshwar**  
**Barclays Bank PLC, Research Division**

That's great. And then I guess looking at pricing, which is also slightly linked to the distribution discussion to some extent, but when you think about the pricing algorithm we've come to expect, it's been in that mid-single-digit growth range over time for Netflix. But more recently, I think when you strip out the effect of the price increases, it's trending a little bit lower than that because of some of the newer plans. So when you think about the pricing algorithm, how are you thinking about that going forward? Is it still the same mid-single-digit kind of a growth profile that you're thinking about? Or has that equation changed?

**Gregory K. Peters**  
**COO & Chief Product Officer**

Yes. I think it's important to start with just reiterating what we mentioned last time that really, for the last several months, we've been principally focused on just making sure that the service has been there for our members when they turn to us for a moment of escape and entertainment. And so we're very much enthusiastic about being able to serve in that role. And actually, we've invested in making the service more valuable to that period of time, adding more content, adding more service features to that period as well.

But when we look forward, I would say every country is in a different mode. And so we're going to sort of continue to assess a bunch of different factors over time. We'll look at macro factors country by country. We'll also look very closely at -- on our specific metrics, and it's metrics like engagement, like churn. And those are the signals that we have for indicating when we have created more value for our members, so back to your plan. And it's not so much sort of an all priority plan that we have but really more using those signs that we've done a good job at building more value for our members, which indicate to us, hey, it might be time to go back to them and ask them for a little bit more so that we can then invest that further into amazing stories, great content, better product experiences and create even more value for them.

**Spencer Wang**  
**Vice President of Finance, Corporate Development & Investor Relations**
And Kannan, just to remind you, we don't narrowly manage towards an ARPU number or an ARPU growth number. Our orientation is really on optimizing for revenue.

**Kannan Venkateshwar**  
*Barclays Bank PLC, Research Division*

Great. And so when we think about the way you manage this whole dynamic on yield, which is revenue maximization, obviously, units are a part of it, pricing is a part of it, but the other important component of this is churn. And that -- and given the scale that you have right now, even small movements in churn can have a massive impact broadly on the entire income statement. And so when you think about churn, given the COVID period and the increase in engagement, is that structurally leading to a better churn performance in cohorts that are potentially newer versus cohorts that came in earlier? If you could just help us think through consumer behavior across this period as engagement has gone up, that would be great.

**Gregory K. Peters**  
*COO & Chief Product Officer*

Yes. Spence, do you want to take that one?

**Spencer Adam Neumann**  
*Chief Financial Officer*

Sure, I can start. I mean the short story, Kannan, is that these newer members look very much like the members that are pre-existing members of the business. So it's very broad-based, and you can see that these members are coming in from everywhere in the world, a few million each in APAC and EMEA and U.K. and then a couple of million in Lat Am. They're highly engaged. Actually, the retention across every cohort is as good or better than pre-COVID. So -- and not surprisingly, the -- this membership base, both new and older, loves film and TV content, as we said, and they look pretty similar. But I don't know, Greg or Ted or others, if you'd add to that.

**Gregory K. Peters**  
*COO & Chief Product Officer*

I think maybe the one thing other than this sort of big structural engagement change which was sort of really a result of people being in lockdown and quarantine and turning to us for some escape, I would say, to Spence's point, backing up the high-level churn pieces, when we look at other sort of metrics that inform how they're engaging with the service, we see it being very, very similar to members we added pre-COVID.

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

And I was going to say, Kannan, it's a little oversimplified, but I think of it as when someone churns, it's always temporary. They're going to come back. It's just a matter of timing as our service gets better, as maybe their income increases, as the Internet gets faster. So we'd love people to get a taste of Netflix. We hope they stay for 50 years. But if they drop out, we think of it as always temporary and we're going to work hard to improve the service enough that they want to spend money with us.

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

It's been interesting to see the evolution of our relationship with that member, where they used to think of us as the place to watch the reruns of the shows that they missed on other networks all the way to now to where they come to us to be their favorite show and now for Friday night at the movies, where you have Netflix premiering the biggest movies in the world on Netflix. So it's an evolving relationship constantly but nothing unique in this subset of folks in terms of their watching and their churn behavior. So it's exciting.

**Kannan Venkateshwar**
Barclays Bank PLC, Research Division

That's great. And then I guess when you think about the product itself, one of the big discussion points has been content discovery because there's an enormous amount of content and there are an enormous number of streaming services now. And so we've got to sort through all of that in order to figure out what to watch. So when you think about content discovery, I mean, Greg, I know you run a lot of A/B tests all through the year, you run hundreds of them. So what are the kind of things you're thinking about in terms of improving the experience? You have the top 10 list. How has that done? If you could just give us some sense of how you're sort of looking at that issue.

Gregory K. Peters
COO & Chief Product Officer

Yes. Well, I'll just -- I'll talk about the top 10 list and then get to the big macro question, which is one of my favorite questions, of course. So thanks for asking that one. But top 10 is an example of a nice, little positive lift in overall engagement. It's not game changing. But more importantly, it actually speaks to what we think is a real member need that some of our members not all have, where they want to know what shows are popular so they can watch those easily and then participate in the broader social conversation that's happening around those shows. But I think it's indicative of the kind of work that we need to go do, right? And I think that we have created literally the most incredible collection of entertainment options that has ever existed available to a consumer at a click of a button. And Ted's team is off producing more and more fantastic content at an accelerating rate. And that is, for our members, simply wonderful. It creates both challenges and opportunities for us as a product team to think about the experiences that we evolve to make the process of choosing and finding a great story in that as delightful and as easy as we possibly can.

And how -- the way we think about it is actually that we have to make almost every aspect of that experience better. And it's not going to be one thing that's going to be sort of like suddenly make a perfect choosing experience. So we have teams that think about exactly how do we pick what titles are perfect for each member, how do we pick those recommendations to make those better every single day, how do we present those titles in a more compelling way, a way that's specific to what we think the member's interest is. We're thinking about how our user experiences work and the features that are included in there. And we want those to adapt and evolve so that they can be responsive to the specific needs of a growing number of members around the world that have growing and diverse needs from our experiences.

So the perhaps sort of unhelpful answer is there's going to be like literally hundreds of things that are going to have to change, but when you aggregate all those changes, they're transformative. And I would invite you to go back and sort of look at a Netflix experience from 5 years ago compared to today, and it's just stunning how much progress we can make through that process. And we are committed to making even more progress sort of in the next 5 years to come to make that wealth of content a joy for our members around the world.

Kannan Venkateshwar
Barclays Bank PLC, Research Division

And so Reed, I guess one of the questions that this raises is given the amount of content, I mean a comment that you had made -- I think this was in 2017, was that Ted was not feeling enough when it came to the success rate of shows and he was not feeling much. Do you think you're at a point where there is enough balance in the portfolio of content that you have? Or do you feel like Netflix has to take more risk in terms of the portfolio? Where are we in terms of that mix in content?

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

I feel excellent about the number of big bets that Ted has coming up. I'm privy to stuff that we're doing now that will come out in 2 or 3 years. And it's a little -- amazing, I mean. And some of it will turn out truly great and I'll be so proud of it. So I'm excited that we're taking those risks. And we want to have so many hits that when you come to Netflix, you can just go from hit to hit to hit and never have to think about any of those other services, right? We want to be like your primary, your best friend, the one you
turn to. And of course, occasionally, there's Hamilton and you're going to go to someone else's service for an extraordinary film. But for the most part, we want to be the one that just always please you with the convenience, simple and easy choice.

Kannan Venkateshwar  
Barclays Bank PLC, Research Division

That's great. And Ted, from your perspective, when you think about production worldwide, obviously, we are still in a shutdown mode and there are still issues around the world. And while things are getting better in Q3, it seems like there would be some impact to the '21 slate given your comments about it being more back-end-weighted. But then on the other side, you also have content that the studios are not able to release quite quickly, right? So when you think about this, does it make you think about the mix slightly differently? Maybe do we get a bit more movie-heavy initially compared to originals maybe later in the year? And what else can we expect because of the kind of disruption going on right now?

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

Well, I mentioned last quarter, one of the benefits of releasing our series all at once is that we work very far ahead of our release cycle. So that's how we're able to continue to release this ongoing steady flow. So even during the shutdown, we're partially shot on a lot of shows. So when we pick them back up, it's not like starting from scratch again. So -- and outside of North America, parts of India and Brazil, we're running pretty much in a normal fashion in terms of our volume around the world, and it's ramping up in different various stages of preproduction. And we've got a couple of shooting days in Los Angeles this week that we're really excited about. Now that's coming back around. So I do think that our ability to keep up with that has a lot to do with our kind of unique offer to the consumer that turned out to be a hidden benefit at a time when things would be shut down.

And the other one was the kind of nimble nature of our creatives who could, on a dime, pick up post-production remotely on shows that we're already running. And as far as film to TV, they both require a lot of prep work, a lot of creative at the beginning, the production and then a big, long post-production cycle very similar in terms of the work cycle. So I don't see us pivoting to that. I do see that there's opportunities. We did a few with the studios to pick up some movies that they were having a hard time releasing. And then we've also picked up a couple of nearly finished seasons of television with a brand-new show called Emily in Paris that we've got coming up later this year with Lily Collins who we really love; and Cobra Kai that we picked up from YouTube, not just the first 2 seasons, but a brand-new, yet-to-air third season that we're finishing right now. And that, by the way, was a show that was super competitive 3 years ago when they brought it to market and we were devastated not to get it for good to start with. So we're excited to have Cobra Kai in the Netflix family.

So there's all kinds of adjustments. Our ability to license and produce, create very long lead and very fast, like you saw us do with the Tiger King finale episode a couple of months ago, I think it's our ability to do all those things that make me really excited to jump out of bed and come to work in Netflix in the morning.

Kannan Venkateshwar  
Barclays Bank PLC, Research Division

That's great. And when you think about different pieces of content, movies versus TV shows or even within TV shows' different genres, is there any difference in origination versus retention characteristics of different pieces of content? Do movies originate better or retain better versus TV shows? I mean is there anything you can tell us about that?

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

Both films and TV can have the same, exact attraction to consumers in terms of what gets them excited, how they behave after, how they retain afterwards, how they tell friends, all those things. A really great experience is what they're looking for. And if -- the chances that they're going to have that are higher on
Netflix than anywhere in the world, going to the thing you cited about earlier about having so many great choices to make. But I think a film, when it's usually successful, can be very acquisitive, can be attention, it could be retention-driving and also could be -- bring a lot of joy to our members. And series can do that as well. So it just depends on what you're in the mood for.

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

Kannan, we have time for 1 or 2 more questions.

**Kannan Venkateshwar**  
*Barclays Bank PLC, Research Division*

Sure. So maybe, Spencer, a couple of questions in terms of the guidance and the financials. I mean one of the things that came out was the free cash flow margin was 15%, and your EBITDA -- I mean operating income margin was obviously 22%. So could you just help us bridge the gap? And how do we think about cash flows going forward?

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

Sure. Thanks for noticing the positive free cash flow margin, Kannan. I'd say 2 things explain that variance. Number one is obviously CapEx. So that was about 200 basis points of the difference between the free cash flow margin and the operating margin. The second expense item was interest expense, which obviously falls below operating income but obviously reduces free cash flow. And there, just keep in mind that while we accrue our interest expense quarterly, we pay cash interest primarily semiannually. So you actually have about -- roughly 2 quarters of cash interest expense in Q2.

**Spencer Adam Neumann**  
*Chief Financial Officer*

Yes. I'd just add. That's great, Spencer. And I'd just add to Spencer's point. When you think about cash flow going forward, it was sort of a bit of a unique window into that forward-looking cash generation opportunity or potential for our business because of the pandemic. So we generally are forward-investing into the growth of our business and into content. So our content cash spend is in excess of our content expense in a given year. But because of the pause in productions, you can see that basically, that cash spend and expense in content were the same this quarter, essentially at a 1:1 ratio. And as a result -- as we said in the letter, resulted in a 15% cash flow -- free cash flow margin. Going forward, we do expect to turn cash flow negative again in 2021 and as our business and our production ramps up, but we're still on that multiyear path to being cash flow positive. And when we are sustaining cash flow positive, we expect to be a much bigger and more profitable business. So hopefully, that 15% cash flow margin is just the start.

**Kannan Venkateshwar**  
*Barclays Bank PLC, Research Division*

That's great. So I guess since we have time for maybe one last question, we could just think about the world going forward, longer term. Reed, from your perspective, a lot of the franchises that are getting created in today's world seem to be coming from the video gaming side. A lot of shows that you have, which have been very successful, have been from that side. And obviously, some of your shows have become video games in some instances. So when you think about the -- and even the interactivity of some of your shows makes them feel like video games. So when you think about the way the world is evolving, it just seems like these 2 sides of the world are starting to converge to some extent, both in terms of the kind of content as well as the experiences. So why not think about video games as an extension of where Netflix is today? If you could just help us think through that framework and how you consider that going forward.

**Wilmot Reed Hastings**  
*Co-Founder, Chairman, President & Co-CEO*
Sure. If you'll think about franchise IP development and Harry Potter and then these hundreds of enormous franchises that come out of full-length books, then there's Marvel and our own, The Old Guard, that come out of a comic book world, and then there might be a few coming out of video games but that's like pretty small. So really, think of it as the big franchises have come out of books and comic books. Now video games, a great and interesting area, it's got a number of aspects in terms of multiplayer that are changing, e-sports that are changing, PC-based gaming. So it remains a very interesting area. But Ted's got big plans to spend future billions in our movies, in series, in animation. And so we've got lots of places to put the money, and we're definitely focused on creating franchises. And maybe, Ted, in your Co-CEO role, maybe you can wrap us up here with final comments and about building franchises.

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

Yes. Look, I think franchise is the active, successfully -- successful world-building. And video games obviously have world-building aspect to them, but so do books and so do graphic novels and so do comic books and so does original IP. And really, this is a matter of how well it's executed. We were really unbelievably encouraged by the first attempt at it here with The Old Guard, which is kind of a new flavor of that kind of storytelling that I think has got a world and stories to be told for some time to come. I look to other things that were more original IP, like La Casa de Papel, which in this quarter, La Casa de Papel was the most watched new season of television on Netflix, hard stop, not just non-English, English. And that's in its fourth season, and it's become an incredible world that we're going to keep building on and keep building on. So IP is a great place to start, but it's -- like everything else in the world, it's hugely execution-dependent. And if you do it well, people want to come back for more. And you don't disappoint them. You can keep doing it. So we're really thrilled about it and thrilled about doing it from a variety of sources.

Kannan Venkateshwar  
Barclays Bank PLC, Research Division

That's great. Thank you all. Thank you.

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

Thanks, Kannan.

Kannan Venkateshwar  
Barclays Bank PLC, Research Division

Thank you.