S&P Global
Market Intelligence

Netflix, Inc. NasdaqGS:NFLX

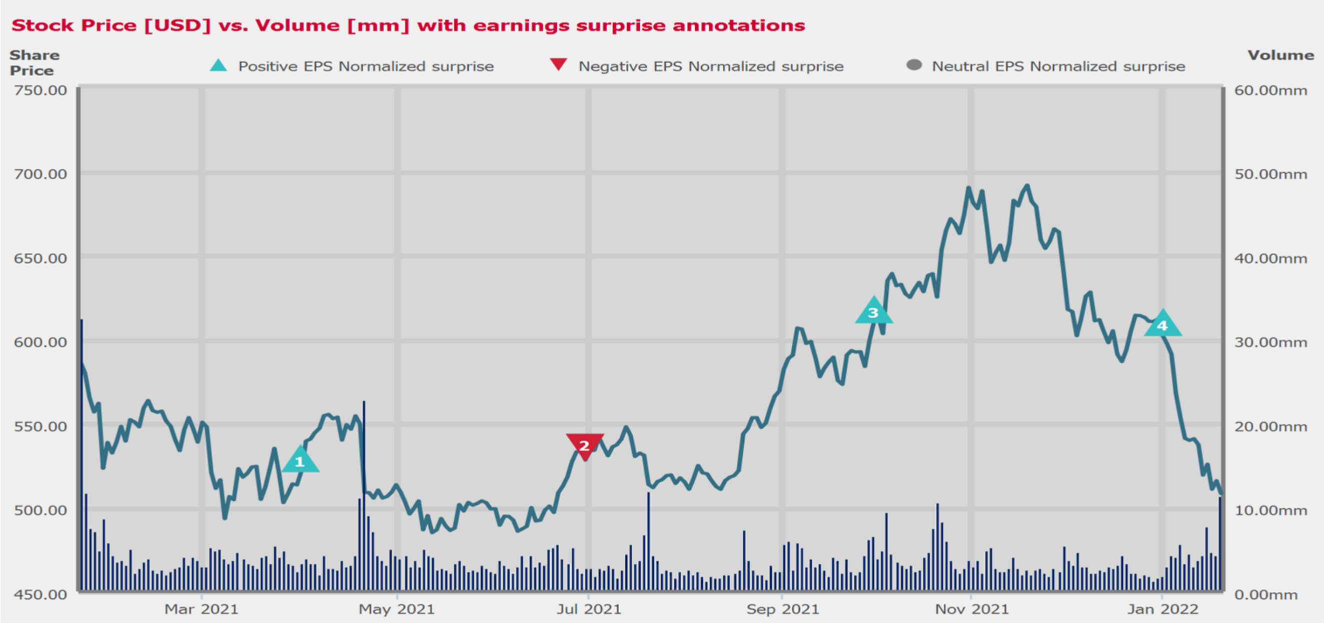
FQ4 2021 Pre Recorded Earnings Call Transcripts

Thursday, January 20, 2022 11:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2021-			-FQ1 2022-		-FY 2021-			-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	GUIDANCE	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.82	1.33	▲62.20	3.45	2.86	10.70	11.24	▲5.05	13.18
Revenue (mm)	7706.94	7709.32	▲0.03	8129.44	7903.00	29703.32	29697.84	▼(0.02 %)	34166.12

Currency: USD
Consensus as of Jan-20-2022 4:57 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2021	2.99	3.75	▲1 25.42 %
FQ2 2021	3.16	2.97	▼2 (6.01 %)
FQ3 2021	2.56	3.19	▲3 24.61 %
FQ4 2021	0.82	1.33	▲4 62.20 %

Table of Contents

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

Nidhi Gupta
Fidelity Management & Research Company LLC

Presentation

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

Hello, and welcome to the Netflix Q4 2021 Earnings Interview. I'm Spencer Wang, VP of IR and Corporate Development. Joining me today are Co-CEO, Reed Hastings; Co-CEO and Chief Content Officer, Ted Sarandos; COO and Chief Product Officer, Greg Peters; and CFO, Spence Neumann. Our interviewer this quarter is Nidhi Gupta from Fidelity. As a reminder, we'll be making forward-looking statements and actual results may vary.
Nidhi, over to you now to kick off the Q&A.

Question and Answer

Nidhi Gupta
Fidelity Management & Research Company LLC

Thank you, Spencer. Good to be with you all again. Great to see all the new content over the quarter. I've been a little less productive so I think I can blame you all for that. As usual, I'd like to start with net adds during the quarter, which came in a little bit later than you expected. Just help us understand the underperformance there.

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

Nidhi, 8.3 million versus 8.5 million, I mean...

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

222 million.

Spencer Adam Neumann
Chief Financial Officer

In fairness, Nidhi said it was a little shy. So I'll take what Nidhi says. As she said, we delivered -- first, we're quite pleased with how the quarter played out. We delivered 8.3 million paid net adds. So it was just a bit shy, about 0.1% on roughly 222 million paying members.

And overall, we're quite pleased with how our titles performed. We had big viewing. We started the quarter with Squid Game becoming a global phenomenon, and we ended the quarter in December with big TV series like the finale of La Casa de Papel, a big returning show in The Witcher, our 2 biggest movie releases of all time.

So overall, the business was healthy. Retention was strong. Churn was down. Viewing was up. But on the margin, we just -- we didn't grow acquisition quite as fast as we would have liked to see, and on our large subscriber base, a small change in acquisition can have a pretty big flow-through in paid net adds. And again, our acquisition was growing, just not growing quite as fast as we were perhaps hoping or forecasting.

Nidhi Gupta
Fidelity Management & Research Company LLC

Great. And as we look ahead to Q1, the guidance was a bit below kind of what was expected and what you've done in previous Q1s. Maybe just help us understand what some of the key considerations were that went into the guidance? And does it raise any concerns for you about anything structural, whether it's competition or saturation? Or does it give you any pause in terms of sort of your return on content spend?

Spencer Adam Neumann
Chief Financial Officer

Sure. No structural change in the business that we see. What's reflected in the guidance, we guided to 2.5 million paid net adds in Q1. And what's reflected there is pretty much the same trends we saw in Q4: so healthy retention with churn down, healthy viewing and engagement with viewing up and acquisition just growing but a bit slower than pre-COVID levels, just hasn't fully recovered.

And we're trying to pinpoint what that is. It's tough to say exactly why our acquisition hasn't kind of recovered to pre-COVID levels. It's probably a bit of just overall COVID overhang that's still happening after 2 years of a global pandemic that we're still unfortunately not fully out of, some macroeconomic strain in some parts of the world like Latin America in particular. While we can't pinpoint or point a straight line using -- when we look at the data on a competitive impact, there may be some kind of more on the marginal kind of side of our growth, some impact from competition but -- which, again, we just don't see it specifically.

So overall, that's what's reflected in the guide. I'd say we -- our big titles are also landing, at least our known big titles, a little bit later in the quarter with Season 2 of Bridgerton in March, The Adam Project also in March. As you know, we also -- while we are taking -- changing prices in countries every quarter, in Q1 of this year, it happens to be our largest country, as we announced last week, actually our largest region with Canada as well. So that's probably a little bit more impact than a typical quarter.

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

But Nidhi, you're right to reflect on 2 years ago, we were 10 million above plan, which was a shock. Last year, we were 10 million below or 9 million. And so the pull forward sort of makes it hard to read. In the prior years, we were very steady, so we can have confidence on incremental trends. But as Spence said, when you -- we reflect, of course, hey, that's a low guide, and we think it will be accurate. It's not sandbagged at all, kind of what's going on.

And there's a number of potential explanations with COVID, but then we worry about hanging too much on that. There's more competition than there's ever been. But we've had Hulu and Amazon for 14 years. So it doesn't feel like any qualitative change there. And overall, confidence in streaming becomes all of entertainment. Linear dissipates over the next 10 to 20 years. Very high confidence in that thesis because everyone's coming into streaming.

So like market size, very large. Our execution is steady and getting better. So for now, we're just like staying calm and trying to figure out. Again, the COVID has introduced so much noise. It just wants us to give it some pause as we work on everything we've always worked on.

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

And just to reiterate, I'd say we took a big bet years ago on this, that people would move on to Netflix and Netflix-type offerings to consume movies and film. That was a big, big bet that we've seen continue to go through. We have no change in our confidence in that.

And I think what's really been great about 2021, even through all those conditions, we were able to kind of prove out to other theses that we've bet on starting years ago one big one around our investment in international programming. We're glad that we started that 7 years ago with Club de Cuervos. And now we were betting that you could take films and series from anywhere in the world and entertain the entire world. And we were getting more -- bigger and bigger milestones against that goal.

And now we have proven to have kind of global sensations from France with Lupin, from Spain with La Casa de Papel and Elite and then in the biggest way possible in 2021 with Squid Game, which has become our biggest series ever. And it is unapologetically and perfectly Korean. So it's not built to be this kind of global thing. It's proving that great storytelling from anywhere in the world can entertain the world.

And our other big bet was our investment in big-budget feature films and our bet that we could effectively release them and compete with big theatrical releases for audience and for attention. And Red Notice this year, of course, and Don't Look Up have become our #1 and #2 most watched movies ever on Netflix. And if you look at the hours that we publish out, you can do the math and back into it. They may be the most watched movies anywhere in the world this year. So I think those 2 bets coming through, it kind of strengthens our confidence in the overall bet in the service and pleasing customers and leaning into consumer-first business models. I think we could succeed there.

Nidhi Gupta
Fidelity Management & Research Company LLC

Yes. No. And I think that's part of the question, right? I mean you -- this was probably the best content quarter you've had. And looking at sort of flattish subs versus previous Q4s, obviously, a great number, but it's kind of in line with what you've done the last few Q4s. What do you read from that? Is the customers sort of hurdle just higher in terms of the amount and quality of content that you need to deliver to get the same number of net adds?

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

Well, I think what, I guess, Spence was saying, we didn't see it -- we didn't see a hit to our engagement. We didn't see a hit to retention, all those things that would classically lead you to looking at competition. But it's a stew of all those things. Not only are we in a pandemic. We've kind of come in of and out of COVID at different levels in 2021, particularly the back half of 2021. So it's created a lot of bumpiness certainly and not steady linear growth, which makes it a little tougher to predict, but all the fundamentals of the business are pretty solid.

Nidhi Gupta
Fidelity Management & Research Company LLC

Got it. You announced a U.S. price increase last week. Maybe just help us understand kind of over what time frame you think this will flow through, what kind of churn you might expect.

Gregory K. Peters
COO & Chief Product Officer

Yes, I'd say you can anticipate it flowing through over the next quarter, the quarter that we're in right now, Q1. And we largely are seeing in the price changes we've done most recently and for the earliest indications that we have in the U.S., which is still premature because we actually haven't actually rolled it out to any customers yet, what we've seen over the last couple of years, which is that sort of core theory that we have that if we've done a good job investing, the member subscription fees that they paid us into better stories, more great storytelling, bigger movies, more variety, then when we come back and ask them occasionally for a little bit more to keep that sort of cycle going, then they're generally willing to do that. And we don't see any significant disruption to the business otherwise in that regard.

And I would say generally, when we look at that sort of core theory and we look at also the competitors, if you look at Disney+ as an example, the other streaming services out there as well, and their ability to grow even as we've been growing as well, I think it's really strong endorsement for the core idea that consumers around the world are willing to pay for great entertainment. And it encourages us to continue that investment and to try and deliver more entertainment value and earn more of that share.

Nidhi Gupta
Fidelity Management & Research Company LLC

Yes. No, it's a good point about your streaming competitors. And when I look at sort of your steady price increases in the U.S., it doesn't seem like you feel too constrained by where those competitors are priced. So is that a true statement?

And I guess as long as you're viewing share is sort of multiples of any other streaming service in the U.S., should we think about your price relative to cable actually as we sort of think about your runway -- not that you'll get there overnight, but as we think about your runway, is that really sort of the comparison we should be thinking about as opposed to other streaming services?

Gregory K. Peters
COO & Chief Product Officer

We don't have an a priori sort of price target in any given country that we're tracking to. Mostly, we're listening to our members and sort of iteratively doing this walk where the metrics that we see in terms of engagement and churn and acquisition and those kind of things are really our signal that we've done a good job at sort of creating this more value and it's the right time to ask for a little bit more to keep that going.

So to the previous comments around competition and things like that, we don't think that it's immediately replaceable or substitutable good, let's say, right? And so if we have incredible stories, movies that you can only see on Netflix, great TV shows, unscripted, now games coming, then that really -- the value equation for any given member or member-to-be in a market is just are they getting good value for what they're paying. As long as we do a good job there, we feel like we're fulfilling that need.

Nidhi Gupta
Fidelity Management & Research Company LLC

Great. You also made a price change in India in the other direction. Maybe just help us understand what you're trying to achieve with that price change.

Gregory K. Peters
COO & Chief Product Officer

Yes. I think it follows a whole set of activities that we've been doing in India over the years that we've been operating there and learning more about Indian consumers' tastes, et cetera. And that's broadening the offering in the service across many, many different dimensions. So it's obviously at the core is the content and the programming and seeking to expand that and provide an increased variety and range of programming that appeals and attractive to more people in India while we're thinking about go-to-market and the partnerships that we have and making sure that we're available with those partners at that place where more people in India will find us, and it gets to payments and many, many, many things.

And when we looked at it and we saw sort of the sum total of all those activities, we felt it was the right time to decrease our prices there, to increase accessibility to all of that sort of -- those incremental value or features that we've been trying to deliver to the market to more Indian consumers. And we also wanted to do it not just like we did with mobile, which is a good lower entry price point, but do it across the range of plans that we had under the theory that some of those features like the ability to watch on TV with a basic plan really unlocks more value in the service and therefore would create more retention, more attractiveness to those plan types for those Indian consumers.

And again, we're doing this through the lens of what's the long-term sort of revenue maximization, our best guess at that exchange. And so in this case, we're -- basically anticipated that while we decrease ARM, average revenue per member, as a result of the price decreases, we're going to make it up in more subscriber adds.

And I would say it's still very early in looking at India. And some of these effects, like retention, it takes a couple of months to get a very clean read on it. But the early data that we are seeing very much supports a positive read on that lens of revenue maximization through these changes.

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

And Nidhi, as you well know, but not all viewers might, what's unique about India is cable is about $3 per month per household. So radically different pricing than the rest of the world, which does impact consumer expectations.

Nidhi Gupta
Fidelity Management & Research Company LLC

Right. Right. If this approach doesn't give you the desired result, and it sounds like it is so far, but if fast forward 6 months or 12 months from now, it isn't giving you the desired result, would you consider sort of rightsizing your content spend in India or maybe consider an ad-supported model? I guess in other words, how hard do you want to push for India? And are there examples of success you see either in the media industry or outside of it that give you the confidence that you can make money in this market long term?

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

I think it would be a long time before we adjust it materially because in our experience in Brazil, it was brutal for the first couple of years. We thought we'd never break even. I know we've got this great business.

And then, Greg, why don't you talk about the experience in Japan?

Gregory K. Peters
COO & Chief Product Officer

Yes. I would use the word brutal in my -- back to that. And obviously, it's a different country, different characteristics in terms of affluence and things like that. But it took us quite a while to unlock all of these components, product market fit, get the right content, all these different pieces. But then once you get that sort of flywheel spinning, it's an incredible market for us and a source of tremendous growth in membership and revenue in the region.

So I think we're quite bullish that India isn't fundamentally different in some way that we can't figure out how to tailor our service offering to be attractive to Indian consumers who love entertainment. We know that for sure. And so that, I think, gives us a lot of optimism just to continue to work away at it.

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

I would just add -- sorry, go ahead, Reed.

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

The great news is in every single other major market, we've got the flywheel spinning. The thing that frustrates us is why haven't we been as successful in India. But we're definitely leaning in there.

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

And there wasn't an easy one in the bunch.

Spencer Adam Neumann
Chief Financial Officer

Well, that's kind of what I was going to say, like what Ted touched on, like for as much as we have what we believe is a terrific business and a terrific business model that scales so well with content that can be created anywhere and travel everywhere. And you see that with our more than 222 basic -- million paying members around the world. It's also super hard. It's hard in every country. And every country is on different adoption curve.

And we talk about product market fit, but it's -- even though everyone loves film and TV and even games, it is very specific. Entertainment is still fundamentally pretty local around the world. So it's global and local, and we need to figure that out. So that is actually a good thing about our business, is that it scales well but it's also super difficult. Otherwise, it'd be really easy for everybody to replicate it.

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

The team going into producing original content in India being pretty -- almost impossible when we first started looking at it. And then this quarter alone, we've got original content coming out from Turkey. We have production in Russia, from Argentina, from Mexico, from Sweden, from Denmark. So we've got original content from all corners of the world with 20 originals coming out of Korea this year.

So the idea that they invested in this early and have built up on it and that it really is going to be something that is going to start to -- we think it will start flowering in India for all the same reasons, a good product market fit, content people love, value that fits through their life and product they can't live without.

Gregory K. Peters
COO & Chief Product Officer

And I'll triple down on that point as well, Ted, because we're -- I mean, we're still learning even now as we have these incredible stories from all these places around the world, how to bring them to that global audience in increasingly effective ways. And it's simple things, obviously, like subtitling and dubbing. And we've subtitled 7 million run time minutes in '21 and dubbed 5 million run time minutes. But at that scale, we're learning actually how to do that better and how to make that localization more compelling to our members.

But it also gets to even like things that you wouldn't even anticipate like just how you present these titles in an emotionally, evocative way. And we describe a story maybe as nostalgic or eerie and that means something to us. But you can't just literally translate that. You have to find out in every culture and language around the world what is that similarly emotionally evocative descriptor that is going to communicate really easily and quickly what a story means. There's just -- there's so much work and incredibly fascinating things that we're learning about how to do that every day.

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

And in many of those places where we built that out, there was 0 infrastructure for subtitling and dubbing.

Nidhi Gupta
Fidelity Management & Research Company LLC

Well, speaking of content that travels well, South Korea, as you mentioned, Ted, has been a really bright spot for you. And as you said, you're launching 20 -- over 20 new shows there this year. What are sort of the unique factors that drove your success in South Korea? And more importantly, what do you think the adoption curve can look like here relative to maybe what you've seen in other markets?

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

I'd say first and foremost, we've developed over the years an incredible team in Korea and South Korea that has worked with the talent community, that recognized the storytelling, that really works in Korea, that didn't try to make it different so it would travel but really try to find all the things about Korean cinema and Korean drama and build them up in a way that people could see kind of new levels of production value.

But it's not like we had to go in and teach anyone in South Korea how to make great content. It's an incredible market for that. And there's always been curiosity around the world. The Kdrama market has always had little pockets of success all over the place. But I think the ease of delivery that we've offered has kind of pushed that into the mainstream.

Yes, there was kind of a turning point with Parasite and Bong Joon-ho's Oscar last year that kind of opened up people's minds to it. But we saw that even way before that with Okja, working with Director Bong, that there was this incredible storytelling culture that we could tap into and that people would love Kdramas and watch them all over the world. It just wasn't that easy to find them. And in Netflix, we've been able to kind of put together the great storytelling and great delivery and a great value proposition that has grown the watching of Korean content in the U.S., the numbers I would have never believed 3 years ago. So 100% growth in 2021 over 2020.

Nidhi Gupta
Fidelity Management & Research Company LLC

Will we get a second season of Squid Game?

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

Absolutely. The Squid Game universe has just begun.

Nidhi Gupta

Fidelity Management & Research Company LLC

Great. Looking forward to that. Shifting gears to Latin America. This region feels like it's maturing at a lower level of penetration than you've seen in the U.S. Is that due to competition, affordability? Account sharing Or something else? Or maybe you disagree with the statement that it's actually maturing. But help us understand if there's anything you can do differently to sort of drive penetration levels there higher.

Spencer Adam Neumann
Chief Financial Officer

Well, first, I just wouldn't necessarily read through that it's maturing faster, Nidhi. I mean again, I just don't want to understate the impact of what we've been going through for the last 2 years. And Latin America, in particular, has been more strained. It has less kind of government funding and subsidization relative to many parts of the world to kind of fuel their economy. On top of that, we also continue to increase prices in that market last year across some big countries for us, Mexico, Brazil, Argentina.

So between macroeconomic factors and general strain, business is still growing there. We grew by about 2.5 million members last year, so under the kind of pre-COVID growth rates but still growing. And it is a market where pay TV is healthy. Folks love film and TV. And so I think there's a long runway of growth there. It's also been a great market for us for Spanish language content that we're creating for the rest of the world.

So we don't see, and the others can chime in, need to change strategy. We continue -- like we talked about with India, we're getting better everywhere, every year. We're getting better with our local content in Brazil and Mexico and so forth. So there's a lot more to come, but it's not a fundamental change in strategy.

Nidhi Gupta
Fidelity Management & Research Company LLC

Great. That makes sense. Maybe just stepping back, you've talked about 800 million to 900 million homes globally outside of China. That's sort of your TAM. You're, call it, 25% penetrated into that. As you're seeing how various markets are playing out in terms of penetration levels, some higher, some lower, obviously, they're all still growing. Has your thought process changed at all on how many of these 800 million to 900 million homes you can have ultimately or sort of the time frame to get there, whether it's higher than you expected or lower than you expected? And how might you actually evolve your content strategy or your pricing strategy to get the next 200 million subscribers?

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

Yes. I'd say, Nidhi, we -- on that pay TV comparison, we look at it. We're, in the U.S., at about 2/3 of the pay TV high-water mark. And so the back third is definitely going to be harder than the first 2/3 in terms of appealing more unscripted, more superhero, and we're working on all of that. Because we don't have sports and news, you might say, well, if we get to 80% or something of pay TV, that's a good accomplishment. But also, streaming TV is such a better experience than the old linear TV. In some ways, we think to ourselves we should be higher than pay TV, a combination of lower pricing and better experience.

So definitely frustrating for us, the current slower growth. That's why it could well be kind of just COVID effects where it could be as you're pushing on smaller market than we thought. But I'm not sure why. So we try to be really rigorous of thinking about the long term. It's possible that we'll get there, but slower than we thought, smart TV adoption, complexity, those kinds of things. But we're still focused on the original thesis of if we become incredibly compelling, everyone's going to want to be a Netflix member.

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

And I know it feels like we've been saying it for a long time, but it's early days. It really is. And I think about the evolving value proposition and how it's still maturing. The idea that big-ticket movies that people really care about premiering and being part of your Netflix subscription is actually taking the value proposition to a new level than it was just a couple of years ago.

So I do think, like I said, it's dynamic market for sure. It may not be as steady as people can think about it in terms of we're going to add X number every month, every quarter, every week. But it's going to -- but there's no question that that's the direction the business is going in.

Nidhi Gupta
Fidelity Management & Research Company LLC

Yes. Yes. And Ted, that's a good segue to where I wanted to go next. You had an incredible lineup of films in Q4 with a lot of viewing. I'm curious, what did having a strong film slate in the quarter do for you relative to periods where you didn't have that? Did you see more aggregate engagement, lower churn, more conversation? Just what is sort of unique about delighting your customers with a film versus a show in terms of kind of the benefits that you see?

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

Yes. There's a big theory, which is that people differently value movies because they always have to pay for it. You had to buy a movie ticket. You have to buy a pay-per-view transaction or DVD. There's always kind of a transactional and a pretty big one for some people to see a big movie premier in your home.

And so there was this kind of temporary effect that some other folks were doing -- this is our -- it's in our permanent model to premier our big movies on the service. And I think people look -- even if you really watch mostly television, you have a movie night, and we can service you on movie night. I think that's a very big important value proposition that we have that's different from everybody else.

And these are the movies that people really love and care about. And you start seeing them at the scale of Don't Look Up and Red Notice in Q4, and it gets you super excited as to what could be next when -- what's coming next. And for that, we have things like The Adam Project coming up with Ryan Reynolds and Shawn Levy directed coming up in Q1. It's a phenomenal movie for the whole family. With a big action movie from the Russo brothers like Gray Man with Ryan Gosling, Knives Out 2, Enola Holmes 2.

So with this movie lineup that would be -- that any one studio would go for any one season, we've got new movies every week on Netflix, and they're big movies that people care about. And we think once the expectation is set and we keep delivering on it, people will react to that, too.

Nidhi Gupta
Fidelity Management & Research Company LLC

Great.

Spencer Adam Neumann
Chief Financial Officer

And Nidhi, I'd just add that at the core, what our members love and what they tell us they love is a great variety of high-quality content, and that means across TV film and hopefully games over time in a much broader way. So having a great film offering is, for us, a key part of that equation. And so I think we're just starting to fulfill more and more of that, our member kind of needs and wants and satisfaction. That's what we're seeing. But it's not like it's just so differential than something else as part of that overall quality and variety of entertainment offering.

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

I also think it differentially serves people watching together. It's much easier to watch a movie together than to make sure you're all tracking on the same episode every week all over the -- if you travel or whatever you do. So that kind of together experience we can deliver on every weekend on Netflix is pretty great.

And I think about even just in the upcoming quarter alone, Spence talked about variety, everyone has a very different taste. So any one movie is only going to serve a segment of the audience. Now you get big, exciting thing like Don't Look Up and Red Notice, you can get to a big chunk of the base, but you're still only getting about 60%. So to do that, to serve everyone, you have to have a big variety of output.

So it does seem like a lot of volume, but it's not all for you. So in Q1 alone, we have The Adam Project I mentioned. We have Munich from Germany; Texas Chainsaw Massacre, which is kind of a reinvention of that franchise; Tall Girl 2, which is a sequel to one of our big YA rom-coms; Home Team with Kevin James. Judd Apatow has got the movie The Bubble. That's all in Q1 and plus original local language films from all over the world as well. So to meet the kind of variety of taste, we're able to really step up and deliver no matter what that taste is.

Nidhi Gupta
Fidelity Management & Research Company LLC

Yes. Yes, that makes sense. Reed, you talked on the Q3 call about sort of, over time, building out the whole experience of games, consumer products, live events, et cetera, around some of your IP. And it obviously starts with great IP and great storytelling. But what else do you have to get right operationally and strategically to really build a franchise? And do you feel like you have the pieces in place now?

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

We're building those muscles steadily with our consumer products, both like the Squid Game tracksuits, and then we're making a big push on experiences that are mobile and portable and people, if we can set them up quickly and developing that muscle. Obviously, the gaming muscle, we're very young on and building. So if you think of a world in a few years where those are strong muscles and then you think of the next Bridgerton or Squid Game coming through, that's what we hope to be able to really pull those pieces together.

And people talk about franchise like it's 0 or 1. But of course, there's a complete continuum that will add value in the short term to our various titles. And we're doing that already through the consumer products world and having people feel a bigger connection to those big franchises. So it's already working, but it's probably, I don't know, 20% of what it will be in a couple of years in terms of the auxiliary boost beyond just the title.

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

Yes. And I'd say on that continuum, Reed, you've got Stranger Things, which I'd say is as valuable a franchise as exist today in entertainment around the world. We certainly have things that are in their early stages of becoming a franchise like Bridgerton, which we launched our second season of this, our second most popular show ever in Q1. And we're also -- this year, you'll see an origin story on Queen Charlotte and this incredible Bridgerton live experiences around the country and around the world that fans will flock to and flood their social media feeds with. And there's consumer products that go along with that as well.

So it's all those kind of makings of a franchise instead of trying to tapping into one that's been building for 50 years. Can you build it from whole cloth? And I think Stranger Things is a proof point that you can.

Nidhi Gupta
Fidelity Management & Research Company LLC

We touched on gaming a little bit. It's very exciting to see some worldwide launches during the quarter. Greg, I know it's early days, but what has sort of the reception and engagement been from the subscriber base? And what have your learnings been as well?

Gregory K. Peters
COO & Chief Product Officer

Yes. As you say, it's tremendously exciting to get to this point because we basically have been building the plumbing and all the technical infrastructure just to get to the point where we can do this, which is consistently launch games globally to all of our members. And it's great to do that.

And now as you point out, we're now really getting to learn from all those games what are the discovery patterns, what are the engagement patterns, how are they performing, what do our members want from games on the service. And it's still very early days. But generally, what we're seeing is not surprisingly, we have a growing number of monthly active users, daily active users on these games. And so we're generally seeing good growth in that regard.

But really, the -- as we're doing this, we've been building in parallel what I'm super excited about it, which is the sort of internal development capacity, our own game studio. We've been hiring some incredible talent that brings a set of experience to this process. We've done an acquisition in this space. And that now allows us to incrementally gradually, over a period of time, get to that sort of the value that you and Reed were talking about where we get to deliver now interactive experiences that are tied to the IP that we're excited about, that are timed with that. And that, I think, is really when you're going to see a next level of unlock around the value we can deliver to members.

Nidhi Gupta
Fidelity Management & Research Company LLC

Given that gamers tend to sort of consolidate their time around a smaller number of titles compared to video where we tend to consume a wider variety of content, does it -- would it be more efficient to sort of buy your way into some well-known titles to sort of anchor the product?

Just the last couple of weeks, we've obviously seen a couple of major companies make big acquisitions or at least announce big acquisitions because this is obviously something that's difficult to build organically. I'm just curious what your reaction to that is. And why isn't Netflix participating in big acquisitions given your aspirations in gaming?

Gregory K. Peters
COO & Chief Product Officer

Well, it's -- I mean it was exciting to see the activity in the space. And I think to some degree, it's an endorsement of the core thesis that we have around subscription being a great model to connect consumers around the world with games and game experiences. And we're open to licensing, accessing large game IP that people will recognize. And I think you'll see some of that happen over the year to come.

But we also see -- back to Ted's like building out a whole cloth and the ability to sort of take the franchises or the big titles, let's call it, that we are excited about and actually develop interactive experiences that are connected to those. We see a huge, long-term multiyear opportunity in that, too.

So we'll -- we're very open. We're going to be experimental and try a bunch of things. But I would say the eyes that we have on the long-term prize really center more around our ability to create properties that are connected to the universes, the characters, the stories that we're building in other places and sort of magnify that value for the fans of those stories.

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

Nidhi, we have time for 2 more questions.

Nidhi Gupta
Fidelity Management & Research Company LLC

Okay. Maybe Reed, just a bigger picture question for you. And Spencer, I might have more than a couple of questions. But you have this global subscription product that's inside sort of hundreds of millions of households around the world. And you really nailed 2D lean-back content, but there is this whole world of interactive or semi-interactive content, whether it's gaming or fitness or education. And at the more extreme end, there's VR content, and now everyone is talking about the metaverse. You've obviously already gotten going on gaming. But as you look at sort of this broad spectrum of content, how much of it do you want to sort of wrap your subscription around thinking about the long term?

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

When you say how much do you want to, that would be a high number. But we have to be differentially great at it. There's no point of just being in it. That's very dilutive of the whole proposition. And so it took us several years to get great at English original series. And you saw in the letter on the Google Search trends how well we did there.

We built with a lot of effort a really strong film franchise, and that's -- Ted calls it just the third inning. It's like we're really just getting going to what we think we're going to be able to do there. Of course, we've got all the international content. We've got unscripted, documentaries. And then gaming, which initially we're focused on the mobile gaming, is a big one.

So I would say when mobile gaming is world-leading and we're some of the best producers and like where we are at film today, 2 of the top 10 for our gaming, then you should ask, okay, what's next. Because we're definitely crawl, walk, run and like let's nail the thing and not just be in it for the sake of being in it or for a press release, but we got to please our members by having the absolute best in the category. And Ted and Greg have been doing a terrific job on that, and we'll just continue to work on that. So queue it up for that. When we're winning in games, then we'll take the question.

Nidhi Gupta
Fidelity Management & Research Company LLC

Great. Spence, just turning over to you on margins. Does the guidance for a lower level of margin -- and you gave a lot of explanation around that in the letter. But outside of sort of the FX impact, does it have more to do with some of these incremental investments we're talking about like games and perhaps consumer products? Or does it have more to do with sort of the lower level of revenue growth that you're expecting?

Spencer Adam Neumann
Chief Financial Officer

No, it's really just FX, Nidhi. So as we said in the letter, we lost about $1 billion of expected revenue in '22 through FX. That's about 2 points of margin. So if you just kind of look at our guide and add that back on, we're right on our pace of adding about 3 points of margin per year. And I can't forget we were overdelivering on margin in the last couple of years.

So that's really all that's happening here. And the FX move happened in really the last 6 months of last year. So what we've always said is we don't want to swing the business unnecessarily fast. We want to be able to invest in a healthy way into our growth opportunities. And over time, we will then rightsize our -- appropriately our investment levels, our cost structure, our pricing in order to rightsize for where the currencies are coming in. And so this gives us some time to do it.

So it gives us a little time, but we will catch back up. We're still committed to roughly 3 -- average of 3 points of margin increase over any few year period. But there's no change there. We've been factoring in our content investment, our game investment all along.

And I just want to say in our growth, too, we talk a lot about this deceleration. Obviously, we'd like to grow faster, but there's still very healthy growth in this business. What you're seeing in -- we ended the year last year with 19% growth year-over-year. What you've seen in the guide is 10% revenue growth for Q1, but that's a bit misleading again because of FX. There's about 4 points of drag in our revenue in Q1.

So the under -- what I would argue, FX-adjusted constant currency for Q1 year-over-year is about 14% growth. It's also a tough comp year-over-year in Q1 because you may remember, we increased prices in the U.S. in Q4 of '20, which flowed through to Q1 of '21 is when it was really materialized. So the year-over-year comp is tough. So the underlying organic revenue growth in the business is, right now, at least in Q1, more like 15%, plus 15%, 16%, 17%. So that's at least just in the quarter.

And that's still very healthy underlying growth in the business. I don't want to dismiss that. We'd love to be growing faster. We'd love to not have the negative FX swings, but it's still very healthy growth in the business.

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

Nidhi, since it's your last earnings interview, I will grant you one extra question.

Nidhi Gupta
Fidelity Management & Research Company LLC

I have one last question. This will be the last one, but it's also for Spence. It's very exciting that you'll become sustainably free cash flow positive this year. Congratulations on reaching this milestone. I feel like I've been waiting 10 years to ask this question. But how will you balance M&A and buybacks with your free cash flow? And maybe sort of related to that, have we peaked in terms of that ratio of cash content spend to amortization? And how long will it take for earnings and free cash flow to kind of converge?

Spencer Adam Neumann
Chief Financial Officer

I can't believe you wanted to end with me, Nidhi. There's so many more exciting people to speak with on the call. So we appreciate what you said there. It is a big milestone for us to be cash flow positive going forward. We're excited for that. The business model has been proving out. So that's great in terms of our increasing profits, profit margins over time as well as cash.

In terms of use of cash, and Spencer, you can chime in, too, but as we've talked about in prior calls, our top priority is to be responsible stewards of the business and our cash but to invest in the healthy growth of our business and strategically invest in the business, first organically, if there's been opportunistically M&A that -- M&A is not the strategy for us per se. M&A is a tactic to accelerate our strategy, whether it's to accelerate our content capabilities and capacity or just acquisition of IP like Dahl across film, TV and games as you've seen.

And what's left over after that, we're not going to sit on excess cash, as we've said. Our capital allocation plan is as it's been, which is to have roughly 2 months of revenue in the form of cash on our balance sheet. And excess beyond that, we'll return to shareholders opportunistically as we have done. We did that to the tune of about $600 million last year in share repurchase, and we're authorized up to $5 billion share repurchase. So that's still our plan.

In terms of when the -- those ratios converge and earnings and cash flow look the same, I don't want to put a prediction out there. We're still very much in growth mode as a business. So it will continue to converge over time, but I don't want to declare a specific peak. It's been going in the right direction over a multiyear period, and it will continue to do so.

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

The only thing I would add to that, Nidhi, is just on the capital allocation part. Just to remind you, our balance sheet target is for gross debt of about $10 billion to $15 billion. We ended the quarter slightly above the $15 billion mark. So as we said in the letter, we will be paying down about $700 million in Q1. But obviously, delevering a bit is something you should anticipate in terms of use of cash.

And then just lastly, on the EPS free cash flow question. So I just want to remind you, there are some below-the-line items like the noncash remeasurement of our euro bonds that can skew EPS in any sort of given quarter, so just a call-out there.

But thank you for your questions. I'm going to turn it over to Ted now to -- for his closing remarks and to take us home.

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

Nidhi, thank you so much for these and thanks for today. The love of film and TV and games has built big businesses for people who can figure out what people love, build a creative environment that creators know how to feed it and then deliver it to fans with a value proposition that they appreciate. I think those fans are positively moving from old linear models and transactional models to more fan-friendly subscription services that are with high-quality programming, delivered well with great value.

That's absolutely happening, and it's happening all over the world. The pace of the migration may be a little hard to call from time to time when there are kind of varied global events or even local conditions, but it's absolutely happening. There's no question of that.

Films that you love and series that you define yourself by and games that thrill you, that's a pretty great business. We're thrilled to be in it. We're also planning to continue to improve what we're doing and to grow this by growing revenue, by growing profits and by growing audience affinity around the world.

So once again, Nidhi, if I can see you in person, I'd give you this. I've got 2 of them. Where is the other one?

Spencer Adam Neumann
Chief Financial Officer

Ted, I found one for you.

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