

# Netflix, Inc. NasdaqGS:NFLX

## FQ2 2019 Earnings Call Transcripts

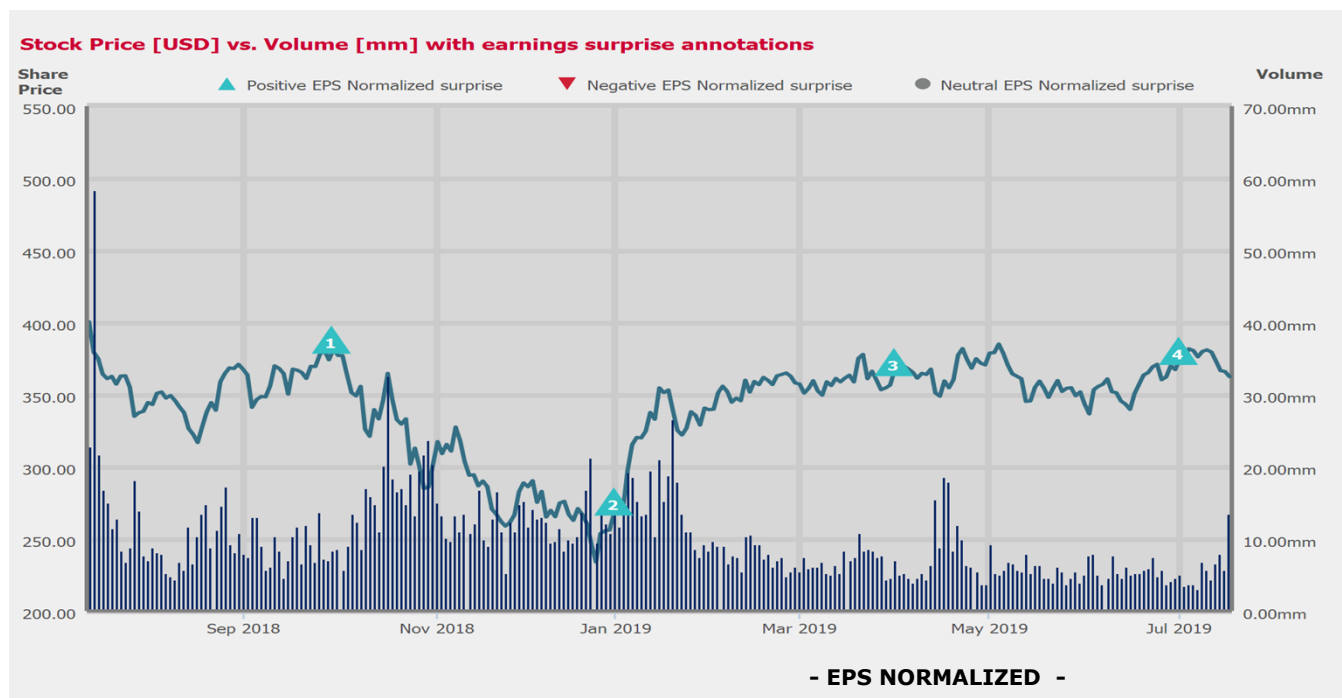
Wednesday, July 17, 2019 10:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-		-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	GUIDANCE	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.55	0.60	▲ 9.09	1.04	1.04	3.39	5.73
<b>Revenue (mm)</b>	4934.49	4923.12	▼ (0.23 %)	5242.65	5250.00	20170.27	25000.32

Currency: USD

Consensus as of Jul-16-2019 2:06 PM GMT



	CONSENSUS	ACTUAL	SURPRISE
<b>FQ3 2018</b>	0.68	0.89	▲ 30.88 %
<b>FQ4 2018</b>	0.24	0.30	▲ 25.00 %
<b>FQ1 2019</b>	0.57	0.76	▲ 33.33 %
<b>FQ2 2019</b>	0.55	0.60	▲ 9.09 %

# Table of Contents

Call Participants	.....	3
Presentation	.....	4
Question and Answer	.....	5

# Call Participants

## EXECUTIVES

**Gregory K. Peters**

*Chief Product Officer*

**Spencer Wang**

*Vice President of Finance &  
Investor Relations*

**Spencer Adam Neumann**

*Chief Financial Officer*

**Theodore A. Sarandos**

*Chief Content Officer*

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President  
& CEO*

## ANALYSTS

**Michael C. Morris**

*Guggenheim Securities, LLC,  
Research Division*

# Presentation

## **Spencer Wang**

*Vice President of Finance & Investor Relations*

Good afternoon, and welcome to the Netflix Q2 2019 Earnings Interview. I'm Spencer Wang, VP of IR and Corporate Development. Joining me today are CEO, Reed Hastings; CFO, Spence Neumann; Chief Content Officer, Ted Sarandos; and Chief Product Officer, Greg Peters. Our interviewer this quarter is Mike Morris from Guggenheim.

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

# Question and Answer

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Thank you, Spencer. Good afternoon. Let's jump right into the results and the member variance from guidance in particular. What changed during the quarter versus the outlook that you provided that made such a significant impact this quarter? And you didn't mention the content being perhaps a factor. I think that's really something we haven't focused on in the past in terms of driving the cyclical, so maybe if could you talk about those things.

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

When we're forecasting, Mike, in the beginning of the quarter, we make our best estimate. And as you can see over the past 3 years, sometimes we're forecast high. Sometimes we forecast low. This is one where we forecasted high. There was no one thing.

And if I think about 3 years ago, we were also light, and we never really were confident of the explanation. Then, we were \$2 billion in quarterly revenue. Now, we're going \$5 billion. And so it's easy to over-interpret the quarter membership adds, which are a bit noisy. So for the most part, we're just executing forward and trying to do the best forecast we can.

Do you want to add anything to that, Spence?

**Spencer Adam Neumann**

*Chief Financial Officer*

Yes. Thanks, Reed. Maybe I'd just add the fact that when we think about those paid net add forecasted, it's really about the marginal growth, Mike. On a subscriber base, it's over 150 million members, so we're talking about plus or minus 1%, 2%, 3% in growth rates on subscribers on an annual basis that are growing over 20%. So if we look at the trailing 12 months, we grew our member base by over 27 million members. If you take that forward to where we think we'll be at the end of Q3, we think we'll be, on a trailing 12-month basis, over 28 million members. So we're really playing for the sustained increase in growth in our membership over time, and there'll be some quarter-by-quarter choppiness along the way based on things like seasonality and content slate and so forth.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Can you provide a little more detail perhaps on the gross add versus the churn dynamic in the quarter, including -- there's the pricing dynamic I want to get to as well, but maybe if we just back up and look at gross adds versus churn and how that resulted in the net.

**Spencer Adam Neumann**

*Chief Financial Officer*

Yes. Sure. I mean generally when we looked at the -- the slowdown in subscriber growth was across all of our regions. So you talk about our kind of top of funnel or gross adds, we saw that slowdown across the board, which indicates to us some level of seasonality and kind of the overall, as we say, the kind of timing of the content slate. And also, frankly, maybe a little bit more pull forward of our subscriber growth from Q2 to Q1 because we had such a strong Q1 with 9.7 million paid net adds. But we also did see in regions where we increased prices, we did see some elevated churn rates and lower retentions. So it was a combination of those 2 things. We think the primary story was around seasonality and timing and nature of our content slate, but pricing played a factor.

Now, the good news in all of that, as you saw, Mike, I think in the letter is that in the first couple of weeks of Q3, that growth has reaccelerated again. We're seeing both that top of funnel growth in acquisitions.

We're also seeing improvement in those churn rates and retention back down towards those pre-price change levels. So overall, encouraged with the trends.

And with regard to that pricing piece too, it's worth kind of reminding ourselves it's all -- that's all very revenue-accretive. So while there may be some short-term slowdown in subscriber growth because of pricing, that increased revenue is very good for our business and ultimately for our members because we reinvest the bulk of that back into great content and great product experience for our members.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Can we talk a little bit about that pricing cycle and where we are right now? So 2 things, I guess, specifically in the U.S. by June, the entire membership base seen a price increase such that there wouldn't be a lagging impact in the September quarter. And then internationally, obviously it's much broader. Can you highlight any particular markets, anything you can help us size the portion of your member base that is processing through those pricing increases?

**Spencer Adam Neumann**

*Chief Financial Officer*

Greg, do you want to take that or do you want me to take it?

**Gregory K. Peters**

*Chief Product Officer*

I'm happy to do that. So I mean in the U.S. situation, we're through all those notifications. Obviously in the international perspective, we've got different markets in different places. But I would say just in terms of helping you size that, I mean we've built obviously that into our forecast for our Q3, so those effects we've already tried to account for and categorize in that forecast.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Okay. Great. And then, Spence, one other question with respect to the letter in the outlook. It's the second consecutive quarter you've come ahead in operating income relative to your guide. You're maintaining the same full year guidance. I know that you've referenced the marketing, but help us there with, again, maybe why the timing. From your perspective, forecasting hasn't been as clear given that it feels that you would know when certain marketing was coming through.

**Spencer Adam Neumann**

*Chief Financial Officer*

Well, it's marketing we have -- and Ted should chime in, too -- but we have some discretion as to when we choose to support titles. And so we're really -- when you look at the back half content slate that we have, we're very excited about -- with Stranger Things 3 already launching, but then shows like Casa de Papel and Crown and big movies in the fourth quarter and money -- sorry, I already mentioned Money Heist, sorry. But there's just -- there's a lot of content to support, so I think it was just really discretion of the team to move some and shift some of that marketing spend into later -- to the latter half of the year.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Okay. So with some of these pressing topics covered a bit, Reed, usually we'll start with an overview question. And so I guess, we're halfway through the year now, this dynamic perhaps aside, any change to your view of the business strategically overall? And I guess embedded in that is touching on that question of your confidence about the growth outlook going forward, and why an investor shouldn't look at this quarter and say perhaps the business is approaching maturity more quickly than we anticipated.

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

Yes. I mean if you look over the past 12 years that we've been streaming, in the beginning, there was Hulu and Amazon and YouTube and Netflix and we've all been growing at tremendous rates over the last 12 years. And now it's really catching on in a big way around the world and we're having a lot of new competitors enter over the next year. And I think our position is excellent. We're building amazing capacity for content. Our products have never been in better shape. Our rate of investment is extremely high. So if investors believe in Internet television, which I think is an easy one to get there, then our position in that market is very strong. And all of the key things are coming our way in terms of, again, stronger content and a stronger service.

**Spencer Wang**

*Vice President of Finance & Investor Relations*

And Mike, if I could just add on your topic of maturation, I would just also point out that revenue growth did accelerate by 400 basis points in Q2 versus Q1. If you look at our guidance as well for Q3, I think you'll see that trend continue as well. So financially, I think that's actually a sign that things are picking up or continuing to grow very steadily.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. Thank you for that.

**Theodore A. Sarandos**

*Chief Content Officer*

I'd also just add too, on a similar or in the same vein, is on a show-by-show or film-by-film basis, we're also seeing -- hitting new heights in terms of viewer penetration and audience reach as well.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Okay. Okay. Great. Let's expand the discussion a little bit. Greg, over the past year plus, we've talked about some of the partnerships that Netflix has struck with the traditional video and wireless providers. I understand each can be different. There can be different accounting treatments. But perhaps can you give us an overview right now where we are on partnerships? Perhaps domestically in particular, how they're impacting the business? Did they have any impact during the quarter? Of course. But just in general, what do we look like in terms of those impacting and where we might go from here?

**Gregory K. Peters**

*Chief Product Officer*

Sure. So yes, there's a long history of these partnerships starting back with sort of the simple device integrations back to the Xbox and Sony PlayStation, but the latest incarnation as we sort of added more capability to each partnership from just the simple device integrations and being able to access the experience, this sort of payment integration and things like that is this bundling that we are doing with pay-TV operators, with mobile operators. And to characterize where we are, we're still fairly early in that process, I would say, from a global perspective. But the bundles that we are doing are nice incremental accelerants to our acquisition, especially into a user population that may not be as tech-forward as the folks that sign up with us directly. They may not have a Smart TV connected to the Internet at home, they may not have an adapter product like a Roku or an Amazon Fire TV, but they do have a set-top box from their pay-TV operator, and if we can put the Netflix application in a nice seamless integration into that set-top box. If we can then include the actual subscription to Netflix as part of their pay-TV offering as a bundle, then it makes it super simple for those folks to be able to get the same kind of experience that our subscribers who sign up with us directly do and get the same benefits.

So we're going to continue to expand those. We've got tons of opportunity, I'd say, globally around the world to add more and more partnerships, so we're still fairly early stages there. But I also -- our perspective is that we anticipate that, that bundle acquisition channel is a nice supplemental incremental component, but a minority component of our overall subscriber acquisition process.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Okay. Let's turn a little internationally as well, Ted. Prior to the results today, data that we had seen indicated some strength in particular markets that seems content-driven strength in France and Germany in particular in Europe; Japan, South Korea in Asia. Curious if you could characterize any particular markets that -- I realize you mentioned the relative weakness. The guide was across the board. But any particular markets seeing more of a tailwind right now, particularly a content-driven tailwind?

**Theodore A. Sarandos**

*Chief Content Officer*

Well, one that we're going to be looking for starting this week is going to be La Casa de Papel that Spencer just mentioned. This is our largest non-English show, which you had to span the places throughout the world at a very high level. We also have Elite and Chicas del Cable from Spain that are enormously popular shows, and new seasons coming in the quarter. And Sacred Games from India, which was a big driver for us in its first season, dropping a new season this quarter as well. And in the past 3 months with the release out of Germany of How to Sell Drugs Online, The Rain season 2 from Denmark and Quicksand from Sweden, what's been amazing is they've been deeply relevant in the home country, traveled the region very, very well and it found global audiences. So the 3 shows I just mentioned from Germany, Denmark and Sweden have 12 to 15 million global watchers. So we're seeing some real locally, regionally and globally relevant content coming from all over the world.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. And you mentioned India. It's a topic we like to dab a bit more into because of the size of the market, of course. So I guess for Ted and for Greg also, in this market in particular, as we approach the second season of Sacred Games, a bit of a milestone, where are we on the content offering? I think you've referenced some other markets where you can start with an original, it gets some traction, but you really need a certain amount of bulk to offer there. So where are we in the content offering in India? I also know you mentioned or I have seen reference that you have 5 other shows, particularly series or projects that we have a green light.

And then, Greg, perhaps tied in with the question about product pricing, you made a reference in the letter to some new pricing. Can you talk a little bit more about both the product and pricing in India in particular?

**Theodore A. Sarandos**

*Chief Content Officer*

Yes. Before we get into pricing, the only thing I would like to add is that our -- we announced 5 new originals for India. The one we're also really excited about later on this year is Baahubali, which is our first step into a really large-scale Indian original film. It's based on a film that was hugely popular a year ago, and this is a series prequel/sequel model that we think is going to be incredibly popular in India. And we've been seeing steady -- nice steady increases in engagement with our Indian viewers that we think we can keep building on. Growth in that country is a marathon. So we're in it for the long haul and we're seeing nice steady progress.

**Gregory K. Peters**

*Chief Product Officer*

So as we're expanding that content offering and seeing that engagement grow, we think that there's an opportunity then to be able to broaden the access to the service and so more people can enjoy that increasingly relevant content offering. So that's clearly the motivator behind adding this mobile tier offering, which we think -- it's going to be a lower price point. In a market where the typical pay-TV package is under \$5, we think we need to have a lower price offering to improve the accessibility, but also one that complements the existing tiering structure that we have. So that's the primary motivator for that move, so we can broaden the audience that can love that content, enjoy that content that Ted's team is



making. And that's great because like when we launched Sacred Games season 2, when you have a bigger audience for it, that means we can create more social buzz and more excitement about that show. So we're doing that. We're also working on the partnerships we have in the market because we think there's specific opportunities to improve accessibility via those partnerships as well.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. And Reed, broader question. How do you view your potential subscriber base globally? I think a lot of us use the sort of broadband -- connected broadband marketplace, but how do you see it? I would imagine you see it as larger than that. And historically, you've given us the 60 million to 90 million member outlook for the U.S. Would you be willing to put some parameters on what you think the global opportunity could be? Or why wouldn't you?

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

Well, we do wonder, in the fullness of time, can we be as big as YouTube? YouTube is 7x larger than us roughly in viewing hours, and a phenomenal service. Of course, it's free. So the real question is can we produce enough content that people are willing to pay for? If you look at benchmarks, it's about 700 million households that pay for television outside of China, so that would be kind of the equivalent of the U.S., 100 million, so that's one established market.

Now, do we have enough content in each of those countries? Most of that is local content that gets consumed. But the Internet is capable of some very large customer bases, as you I'm sure well know. So we'll just take it year-by-year and try to have our net adds continue to grow. We still think our net adds this year will be larger than last year. We'll keep pushing on that. And what we want to do is just grow the net ads every year and then the future takes care of itself.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. I want to talk about a couple of broader strategic topics here. Reed, in the past, you've clearly stated that you view your competition for consumers' time pretty broadly, sleep, video games, et cetera. The financial press though loves this concept of streaming wars between Netflix and a number of existing and new platforms. So do you think that streaming wars is a fairer characterization of what the future holds for Netflix and for video entertainment?

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

Yes. I mean high level, it is. Certainly, all of Ted's world is very competitive. It's never been a better world for talent. They get to bid themselves off between us, Disney, Amazon, et cetera. So there's a real battle for who will pay for content around the world, but it's not a zero-sum competition. I think everybody gets that people will subscribe to multiple shows. Add wage -- most Netflix employees are HBO subscribers. We love the content they do and that spurs us on to want to be even better. So it's a great competition that helps grow the industry. And the advantage of having something catchy like the streaming wars is it draws more attention. And because of that, people, consumers shift more quickly from linear TV to the streaming TV.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. Greg, over the past 12 months, you've spent -- the company spent approximately \$1.5 billion on technology. I mean a couple of specific questions. First, can you help us understand sort of the scalable part of that spend versus the incremental part of that spend? And maybe to the extent you can quantify, Greg, to the extent you can perhaps talk about the types of things that would fit into 1 of those 2 buckets, that would be great.

And I think also a question that we get is really how your technology spend can be a competitive advantage in this competition for subscribers. So is there anything you can point to from the consumer perspective where you really feel like it's, whether we see it or we just enjoy it, that separates the Netflix platform from the competition there?

**Gregory K. Peters**

*Chief Product Officer*

Yes. There's a lot there, so let me try and take it piecewise. I would say the majority of that spend we would say is a fixed cost investment which returns increasing benefits at scale. So as we grow our business, we get higher leverage off that fixed cost investment. There is a small portion of that, that I would say is sort of incremental to how we scale that -- you can think of that as either on the deliveries cost side. We seek to invest on the content delivery side to make that more efficient, so that's a fixed cost, but then we obviously have certain elements of that cost which just scales as we grow the business as we deliver more streams, right?

But a couple of examples on this so you can see the benefits from a consumer perspective, just to pick a few. So one is when we think about sort of our encode efficiency. And this is how we actually take the moving pictures that our creators produce and then reduce them into a digital form so that we can actually deliver them to a variety of different clients, a variety of different devices around the world in a wide, wide range of network conditions back to like gigabit-plus, constantly reliable all the way to super flaky networks that we see in markets, let's say, in a mobile environment. And so we try and make that encoding process so good that pretty much we are maximizing the capability that we have, the connection that we have to any given consumer in that wide range of environments at any point in time. So obviously, that's the consumer benefit is realizing just a good quality picture experience and more engagement, more compelling immersiveness in the content. So that would be an example on that kind of fixed cost return.

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

And Greg, about how many AV tests do you guys have running currently?

**Gregory K. Peters**

*Chief Product Officer*

So let's say, in a year, we'll run, let's say, 400 is a good benchmark. And these are situations where we're -- we have a theory, a hypothesis of how do we present a better experience which is more compelling to our users which gives them a better experience, more engagement. And we'll test it out and then based on how the users actually use the service, we'll determine if that hypothesis was correct or not. And obviously, the ones that work, that are a better experience will roll out largely to our whole universe typically of users around the world.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. Another -- a place you didn't quite mention was the user interface itself. We do get questions about discovery and particularly with all the content that's being invested in. There's a survey that I just read about from Nielsen. 2/3 of streaming users know what they want to watch when they go to the service, but another 1/3 look and they spend 8 to 10 minutes, according to the survey, looking for something to watch. So that's my question for you. Does that seem right based on anything you've seen? But also, is that a good thing or a bad thing? And where is the interface, from your perspective, to making that great?

**Gregory K. Peters**

*Chief Product Officer*

Sure. I mean we obviously track those numbers. We have our own metrics that we use around how our members engage with the service, how much time they spend in the discovery process, et cetera. So we have our own view on that. And I think the Nielsen numbers are -- they're a good sound-bite, but

don't reflect the typical experience. And I would say generally, I think we're doing a pretty good job as evidenced by sort of our growth and engagement and general growth in subscribers.

Now, having said that, we're bringing a tremendous number of titles to the service and many titles which people don't know. They haven't heard of it before. So we have an opportunity to continually improve and get better and better in how we present the right titles to the right audience and in a way which is meaningful to them, which explains to them why a show is relevant to them and gets them excited about watching that. And so a lot of those 400, call it, AV tests that we run in a year are around trying to figure out how do we do a better job at that. And we have a healthy road map of good ideas about how to make that better and better, and we're excited about that. We think that, that is a competitive advantage. If we do a good job there, we can deliver a better service experience that unlocks the value of our content library in a more effective way.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. Great. Okay. So I want to talk about some key content-related items. And I think we know the well-publicized topics that I want to get to. But first, Ted, can we just talk about your current strategic point of view on investing? And I'm thinking about allocation of resources across a couple of vectors, global versus local market-focused content, films versus series, and I think Netflix-branded versus licensed. Just if you could tell a sort of from a high level where you stand on how you're splitting your resources there.

**Theodore A. Sarandos**

*Chief Content Officer*

Well, the one -- one of those 3 that cut across all of them is the original branded content versus license, which is producing the kind of programming that is globally relevant and globally important. And I think we've seen shows like Stranger Things right now that plays almost completely globally, performing off the charts in every country in the world. We saw similarly last quarter with Umbrella Academy, a show that is incredibly a global show. So there's plenty of content that is global and there's a lot of content that's very, very specifically local, and we're balancing constantly between those 2. And every once in a while, you get something out of like La Casa de Papel from Spain that also becomes a global phenomenon that has nothing to do with what we've seen for -- since the beginning of film and television, that almost all content that travels the world is in English from America, and we're seeing those dynamics change pretty rapidly. But at the same time, it's a very large audience and about most of the English-speaking content travels. So we're constantly doing those trade-offs between the 2.

The overarching strategy that we're continuing to drive toward is, over 6 years ago, we got into original programming, betting that the license program would be more and more difficult to come by and that maybe the sources of original -- of license -- of content to license for will be under different levels of strain. That has paid off, we think. We think it's been very important to the business to continue pushing down that road, so the more international, more global, more original film. We also have a large investment coming up in animation that will serve us to see some of the fruits from early next year. So we're -- we think we're betting in all the areas of content that our consumers love.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

And just a follow-up. Film has been something where, clearly, we've seen more volume and more focus, at least on a relative basis. Can you talk about why film is incrementally important for the platform overall relative to the series? And is it fair to say that more effort is going there? Because it certainly feels like it from our perspective.

**Theodore A. Sarandos**

*Chief Content Officer*

I would say more effort than in the past couple of years and I'd say more successful effort in the last -- than in the last couple of years. So that's what I've been most excited about. When you see a film like Murder Mystery hit an audience as large as it has, you'd start thinking, well, we really aren't

benchmarking against our ability to license Pay 1 movies. We're benchmarking against the consumer perception of what movie they want to see on Friday night. So that competition is for very large-scale films, for very intimate indie films and everything in between. And I think the team has done an incredible job this year in punching those films out into the zeitgeist, becoming the most talkable moments like Bird Box, like Murder Mystery. We think in Q4, with Irishman and 6 Underground, that these are the kind of films that people just think about when they want to watch a movie and they're not -- not when they want to watch a pay-TV movie.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. So you mentioned this, Ted, and I'm happy to ask you and open it up more broadly, but really a big question about the high-profile content coming off the service over the course of the next year or so. I think the first question is about impact, and you addressed it a bit in the letter, but when -- we have The Office, we have Friends, we have the Disney-branded content in particular coming off the platform. So again, you addressed it a bit. I'd love to hear any expansion on it. One is just how much of the viewing consumption does this make up? Either person-by-person, I think there'd be differences between the amount of viewing and the number of members that are viewing it for one day. There's also a domestic and international dynamic. And then also just the sort of historical precedent. You have had content like Family Guy, X-Files, things like that, that has come off. What -- help us with the precedent to how we should think about this.

**Theodore A. Sarandos**

*Chief Content Officer*

Since we started streaming 12 years ago, the consistent dynamic is that content comes and goes. The licenses come on, they expire, they get competitive, they go somewhere else, that's been true. This is the kind of second round with the Pay 1 Disney films. Remember back in the day, we used to license them through Starz and had them on Netflix and it was a big swing off, along with films from Sony at the same time.

So we've seen the entire output from Fox. We've seen the entire Nickelodeon kids output come and go on the site. And we grow through that by, we believe, by making these early investments in original programming and getting our consumer and our members much more attuned to the expectation that we're going to create their next favorite show, not that we're going to be the place where you can get anything every time. And we think there's more value in that proposition than there would be in the kind of low price aggregator.

**Spencer Adam Neumann**

*Chief Financial Officer*

Mike, the only thing I might add to that is just, as Ted said, we've been planning for this for a long time, but when you look at our -- we don't have any overconcentration in any single studio or any single show. We talked about it in the letter. Any single show, even the most viewed shows are single-digit -- low single-digit percentages of viewing. And there is going to be -- as content rolls off the service and when and if it rolls off the service, it's going to be over time. If you look out 3, 4, 5 years from now, that second run license content, there's still a very meaningful portion of what's on the service today that will still be on the service 4 or 5 years from today. So we're just going to continue to focus on our strategy of developing more and more original programming. And obviously, as Ted said, if there's a second round license programming that's available, then that's still part of the business.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Understood. Before, we talked about that allocation of budget there. The international versus domestic dynamic for some of that specific high-profile content that's coming off, is the consumption of it and the availability of it consistent on a global basis? Or is this primarily a domestic phenomenon? How should we think about that?

**Theodore A. Sarandos**

*Chief Content Officer*

It's primarily domestic now. Like it's -- by way of example, we just recently added Big Bang Theory to a lot of our international territory. We never had it available to our -- in the U.S. So I think it's international -- it's more of a domestic-driven initiative today that -- and success, we believe, it will be an international one, too.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Okay. And then, of course, you're spending money on this content. So it's not like it's just leaving -- you have resources being freed up, if you will.

**Theodore A. Sarandos**

*Chief Content Officer*

Absolutely.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

When we talk about though the availability of product, if there's one thing to take a sort of iconic piece of content off the shelf and not have to have it recreated. When we think about redeploying that money and expanding your budget even further for originals, are there constraints on whether it be talent, any types of resources available? Or do you think that there's ample opportunity to go out and redeploy that?

**Theodore A. Sarandos**

*Chief Content Officer*

We definitely think there's ample opportunity, particularly across film and television. Like we said, a couple of years ago, we were not investing in animation at all. And today, we're investing very aggressively. I also think that the emergence of the next global storyteller being from anywhere in the world certainly opens up that opportunity, and we are becoming much more seasoned producers all over the world to do that.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Okay. Great. Now, you are investing more on your own capabilities, of course. And Greg, I think that one thing that we don't talk about much is the technology side of the studio and production. Is there an opportunity for Netflix as a technology company in addition to being a media company to take advantage of some opportunities to be a more efficient studio, a better studio in terms of what you're working with Ted on?

**Gregory K. Peters**

*Chief Product Officer*

Yes. So if you think about the number of titles that we are producing and the strength that we have in technology and analytics, we do think that there is an opportunity back to the discussion we just had around making a fixed cost investment, either in terms of efficiency benefits or outcome benefits, just the quality of the dollars that get to the screen that impact the user across the range of titles that we are producing. Now, I would say it's early days here. So we're trying now replacing a bunch of bets and we'll see sort of how those bets play out.

But just to give you a sense of -- make it a little bit less abstract and more concrete, when you think about after show or a movie has been made, you make a trailer to promote that. We use this on-service. We use this off-service, right? And typically, the first step in that process is someone goes through and they look at all of the scenes in that show, for example, and they inventory like who are the characters, what's happening there, and that sort of provides us index so that they can actually take that material and then from that, use that index to assemble, in the creative process, what's a compelling trailer. Well, we can increasingly use automation, use a technology investment to basically do that indexing process so that

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our trailer creators can really focus their time and energy on the creative process, taking the result of that automated process and putting together something which is super compelling, tells a story of what the show is in an authentic way and makes it more attractive to users. That's just one example of the kind of investments that we are making that we think have that kind of returning leverage against scale.

**Theodore A. Sarandos**

*Chief Content Officer*

And I would just add that being an efficient producer is a very good thing to do obviously, but being an efficient distributor and being an efficient marketer is P&L-changing. So that's a way to think about. We're working in all 3 of those things at the same time.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. I want to move a little bit to the reporting and the granular reporting of data that you referenced on the last call. One of the places we're seeing it more clearly is in the U.K. with the top 10 list. So my 2 questions are, #1, can you share any results from that U.K. top 10 list, #1? And #2, what can we, as consumers or members, expect going forward? And then I have one follow-up with respect to what it means for the talent, of course.

**Theodore A. Sarandos**

*Chief Content Officer*

Well, the one thing we are -- we said this in the last call as well. We think we are being much more transparent with the creators and increasingly with the public in terms of what's being viewed on Netflix, mostly because I think people use a lot of different inputs to figure out what they want to see, and popularity is definitely one of them. And we're trying to figure out how to balance off popularity against some all the other personalization tools to get people that opportunity that if they want to see what everyone else is watching in their country, in their city, in their town, that we can present that to them in a way that helps them make better choices. But in general, I think we're still testing the best application of that and it's still very much in active testing mode.

**Gregory K. Peters**

*Chief Product Officer*

Yes. I'd just want to comment. I think we feel like there's a great way to actually enable that personalization, but enable popularity signaling for the users that want it. It's just basically looking at the folks that use that popularity as a factor in the decision-making they take about on what to watch next and making sure that those popularity signals are available and very present for those users. And for users who don't seem to want that, then we can sort of make those less present.

**Theodore A. Sarandos**

*Chief Content Officer*

Yes. And there -- as an example of a very granular piece of data that we shared recently was in the first 4 days of Stranger Things 3, more than 18 million people watched the entire season. And why share that number? Because the very next follow-on to that was, wow, I'm one of those 18 million. I want to tell my friends about it. Or oh my God, I want to be one of those 18 million. Or are you one of those 18 million? So it creates a lot of excitement in the fan base when you can give them some data to chew on.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

So from a public perspective or from a member perspective, should we expect more consistency in that type of data? Or is it going to be a one-off on selected items that you feel are valuable?

**Theodore A. Sarandos**

*Chief Content Officer*

Yes. I think we'll be increasingly transparent with producers and then, over time, more and more. I really like that it's important for us to help condition the market to understand what the viewing data is so it's not being compared apples-to-oranges against things that are not similar. And right now, if we start publishing tomorrow, we'd be the only streaming service doing it.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Right. Right. So the value of this data to your content partners, content creators, as you create more of these large-budget films, you have actors or other talent that historically perhaps were compensated on box office performance. How are you approaching that when you want to make these big-budget films and you want to incentivize talent? And maybe the flip side to that is perhaps you have a little protection if a film doesn't do as well. In the traditional model, is there a way that this data starts giving you both the incentive and the protection?

**Theodore A. Sarandos**

*Chief Content Officer*

Yes. I think -- and what we're trying to do is it's a very new model, particularly for box office-friendly talent who want to make their next big film in Netflix. So we have to figure out a model that, in success, how would they be compensated? The fact that it's guaranteed, there's some discount applied for that. And in fact, if it's paid out over a quicker period, there will be discounts applied for that. But ultimately, we want the economics to be pretty neutral or at least are similar to what they would be if they had a big hit film in the theaters. And that's what we negotiate film-by-film, talent with -- actor-by-actor.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Great. I'll open this up to anyone, Reed perhaps. Looking at the product placement or rather product partnerships for Stranger Things, certainly very high profile, a lot of buzz, very broad. In the letter, you referenced it as being more about building the product itself versus monetizing. Does it become a monetizeable part of the business at some point? Or put differently, expand a bit on the benefit of doing that and how that might be broadened to other properties.

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

Well, we're monetizing it today in more membership growth. The focus is get more people excited about Stranger Things. So they join Netflix. They tell their friends about it. So this year, we'll add about \$5 billion of incremental subscription revenue, which is almost all of gross margin, and that's faster than any entertainment company has grown in the history of the world. So what we want to do is keep that engine going, keep that subscriber engine going and not get distracted with alternative revenue sources which just don't add up when you're growing \$5 billion a year. So the core focus is create all these merchandising opportunities, tie-ins, touch points so that you feel the Stranger Things energy so that more people join. So together, as we do monetize all that, it's just we're monetizing it through our giant engine rather than through little sidecar vehicles.

**Spencer Wang**

*Vice President of Finance & Investor Relations*

Mike, I think we have one more...

**Theodore A. Sarandos**

*Chief Content Officer*

You should think about -- particularly in the case of Stranger Things 3, you should think about all those product partnerships as a character in the film -- in the show. Remember, the show is set in 1985 and it's set in the heart of -- when the big summer blockbuster movies were jammed with product placement, and there was really a creative choice when they talked about pitching that season out more than -- almost 2 years ago.

**Spencer Wang**

*Vice President of Finance & Investor Relations*

Mike, we have time for one last question, please.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Okay. Great. Usually, we like to do a big picture, but this is one very specific financial question that we get a lot, and it's really about the margin potential of the business over time. I think it ties together a lot of these different things that we just talked about. But Spencer, we've had the chance to hear your opinion a bit. I'd love to hear you expand on it. Because Netflix is a single revenue stream product, you are very clear in the letter that advertising is not part of your future despite what we read in the press. Can Netflix ever achieve the type of margins that we've seen historically out of cable networks, be it an HBO, which is a unique single revenue model whether -- or another network that was a dual revenue stream? Or are we inherently going to be sub-historical average margins for Netflix on a global basis?

**Spencer Adam Neumann**

*Chief Financial Officer*

I mean, you take it or you, Reed? I can take it.

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

You got to do it.

**Spencer Adam Neumann**

*Chief Financial Officer*

Okay. Well, look, yes, I think, yes, we've demonstrated over the last few years that we're focused on building a very healthy long-term business model and growing those margins roughly 300 basis points for the last few years to a target of 13% this year. When we go for -- when I look forward in terms of the margin potential and scale the business, first, Reed talked about it a bit earlier, our aspiration, for a business that's already at 150 million paying members, is to be a multiple of our current size. So that is a network with a relative scale for a premium entertainment network that really hasn't been seen before for those comparables that you mentioned in terms of those historical margins, so that works in our favor.

And we also think about the revenue per any individual subscriber, and whether that's advantaged with a dual revenue stream or a single revenue stream. And our calculus now for building a global network is that we're best served to focus on that single revenue stream, winning those moments of truth with a great member experience and then continuing to price occasionally against that in a great value proposition when we start with great content, create experience and then offer it at a reasonable price. We think we can do that in a way that obviously continues to scale margins in a very healthy way.

We're not going to provide specific guidance. But when you look at those comparables, there are some things that work in our favor and some things that don't. So scale is in our favor. We think the subscription model is a terrific model for us. So certainly, we believe that there's going to be more margin accretion over time. And again, I'm going to kind of leave it at that, but you can assume that we have a long way to go.

**Theodore A. Sarandos**

*Chief Content Officer*

And Mike, well, we don't want to end on something that dry. I could say 2 things really quickly. One would be that -- to congratulate HBO on an incredible record-breaking year at the -- for Emmy nominations. They are -- continue to be the gold standard that we chase, and we're really thrilled for them.

And also to the end of this month, in July 26, we're going to wrap up our seventh season, our seventh and final season of Orange is the New Black. And I wanted to thank Jenji Kohan for her incredible vision that



helped really drive this whole idea of Internet television to new heights. And the show wraps up in a really incredible and emotional high and we hope the fans love it.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Awesome. Great. Thank you for livening that up, Ted.

**Wilmot Reed Hastings**

*Co-Founder, Chairman, President & CEO*

Thank you, Mike.

**Michael C. Morris**

*Guggenheim Securities, LLC, Research Division*

Thanks.

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