

Netflix, Inc. NasdaqGS:NFLX

FQ3 2024 Earnings Call Transcripts

Thursday, October 17, 2024 8:45 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2024-			-FQ4 2024-		-FY 2024-		-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	GUIDANCE	CONSENSUS	GUIDANCE	CONSENSUS
EPS Normalized	5.13	5.40	▲ 5.26	3.93	4.23	19.19	NA	NA
Revenue (mm)	9767.06	9824.70	▲ 0.59	10023.11	10128.00	38798.07	NA	NA

Currency: USD

Consensus as of Oct-17-2024 10:19 PM GMT

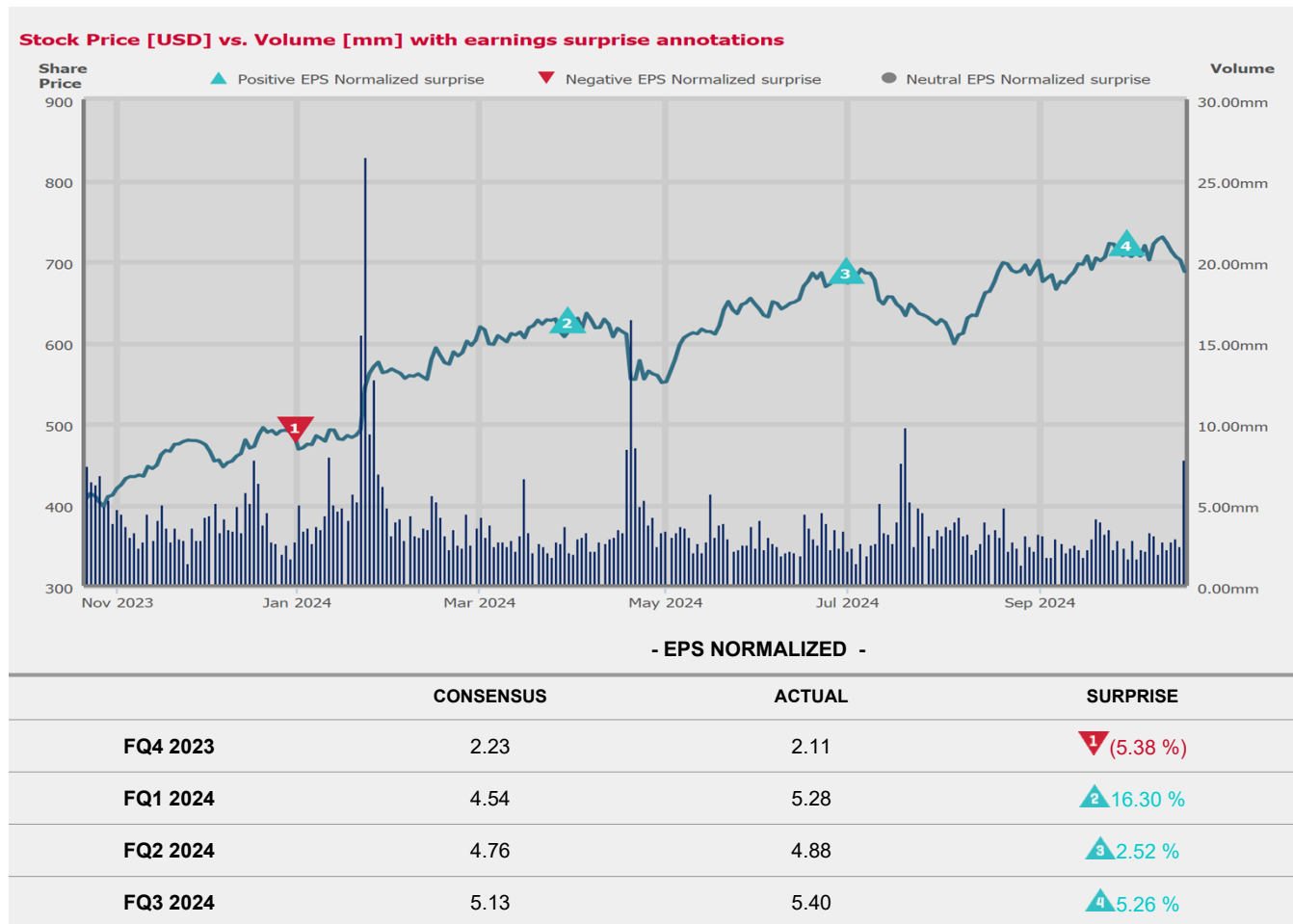


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Call Participants

EXECUTIVES

Gregory K. Peters
Co-CEO, President & Director

Spencer Wang
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Spencer Adam Neumann
Chief Financial Officer

Theodore A. Sarandos
Co-CEO, President & Director

Presentation

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Good afternoon, and welcome to the Netflix Q3 2024 Earnings Interview. I'm Spencer Wang, VP of Finance, IR and Corporate Development. Joining me today are Co-CEOs, Ted Sarandos and Greg Peters; and CFO, Spence Neumann. As a reminder, we will be making forward-looking statements, and actual results may vary.

We will now take questions submitted by the analyst community, and we'll begin with questions about our Q4 results and our outlook.

Question and Answer

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

The first question comes from Eric Sheridan of Goldman Sachs. Can you please frame your key investment priorities for 2025 and beyond? And how have they evolved in the past 12 to 18 months?

Theodore A. Sarandos

Co-CEO, President & Director

Thanks a lot, Spencer. Let's start with looking into 2025. We're feeling really good about the business. We had a plan to reaccelerate growth, and we delivered on that plan. You can see that in our 2024 financials. We expect to deliver 15% revenue growth and 6 percentage points of operating margin improvement and engagement, which we view as our best proxy for member happiness because when people watch more, they stick around longer. So that's retention. They talk more about Netflix, which drives acquisition. And they place a higher value on their Netflix subscription.

This year, we've maintained very healthy engagement, about 2 hours of viewing per member per day, and engagement on a per owner household is up through the first 3 quarters of 2024. So if you look at where we're sitting now, we finished Q3 with some big hits: Perfect Couple, Monsters: The Lyle and Erik Menendez Story, Nobody Wants This. And we're really excited about our Q4 slate because it's filled with great big titles from the U.S., from Brazil, from Korea, from the U.K., from Germany. And we also have got some really amazing live events coming up.

So when we look forward into 2025 and beyond, we want to build on that success. We plan to build on that success. And we've been making original programming now for more than a decade. And the core has become very strong. We have a team of people who are the best creative talent around the world. We have a culture and an operating model that allows us to create stories in more than 50 countries and thrill audiences of more than 600 million people all over the world. So our 2025 slate, I look at that as another ambitious step towards this push to make us even greater for our members. So it really showcases the scale and the ambition and reflects the investment that we've made and the steady cadence of programming.

So looking into 2025, you've got new seasons of our biggest shows: Wednesday, Squid Games, Stranger Things, on top of new shows from Shonda Rhimes and Ryan Murphy, a new Knives Out film from Ryan Johnson, Guillermo del Toro's Frankenstein, even the return of Happy Gilmore. So we could not be more excited about where we sit right now and where we're heading.

Gregory K. Peters

Co-CEO, President & Director

Just jumping on that, we've always been focused on trying to constantly improve every aspect of our service. It served us quite well for the last 1.5 decades. We hope and expect it will serve us well for decades to come. And then the question -- I mean you mentioned priorities, too. And our top priority is really bringing that mindset to improving our core film and series offering.

I think just to double down on what Ted was saying, we've seen really good progress on that front and on our plan. One of the things that I like the most is increasingly seeing a steady drumbeat of hit titles from countries around the world. Ted mentioned a bunch, but you've got Japan. You've got Korea. You've got Thailand. You've got India. This represents, again, that decade-plus investment in those creative communities, working with local storytellers there and making sure that they have the capability to tell their stories in a compelling way. So that's super exciting and we expect to see more of that.

Also improving the product experience. We tested a new more intuitive version of our TV homepage. We're excited about the progress that we've seen there, so we're polishing it up, and we're excited to bring that to our subscribers around the world.

Our second set of priorities are about planting seeds, these investments and new initiatives that help us expand and strengthen our entertainment offering and that we believe will be incremental levers for growth in the coming years. We've got initiatives like games. We're excited about games based on Netflix IPs. We got a Squid Game coming. We've got a Virgin River Christmas. We've got The Ultimatum. We've got games based on storied game classics like Monument Valley 3 that's coming out.

We're also expanding into live. We've got the Tyson-Paul fight, NFL in December. We got 52 weeks of WWE coming in January, John Mulaney and more and more. And then we're also growing advertising as the principal goal here is the more effective way to give members and members-to-be a lower-priced plan to access all of that great entertainment.

I think it's worth noting, it takes time to build these new initiatives to the point where they're significant given that we already have a fairly large core business. And ads is a great example of how we approach growing these seeds. It takes a lot of work, but we know the path, and we're hustling to move down that path as quickly as possible. And you can sort of see some of the benefits that we're getting.

We're roughly doubling revenue each year, but it's off a small base. So it starts to become a material contributor of revenue over the next several years. But if you step back and you think about this opportunity ahead of us, over \$600 billion in consumer spend in the areas and countries that we operate, we're only capturing roughly 6% to 7% of that today. That's tremendous upside if we can just stay focused on that continuous improvement and drive to that future.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Ted and Greg. Our next question on our outlook comes from Jessica Reif Ehrlich of Bank of America. At a high level, when we think about the Netflix revenue growth algorithm, can you please provide some color on the pieces moving forward between organic membership growth, ARM increases and advertising? Spence, maybe you can take that one.

Spencer Adam Neumann

Chief Financial Officer

Sure. I'll try that one, Jessica. So really, those investment priorities and that focus that Greg and Ted just talked about really are the engine that kind of drives that growth equation. But if you look at our 2025 guide as a proxy for that evolving mix or components of our growth over time, I'll walk through that a bit as an indicator.

So we expect to deliver roughly \$43 billion to \$44 billion of revenue next year based on FX rates at the end of Q3. That represents about \$4 billion to \$5 billion of incremental revenue over our kind of 2024 expected landing where -- think of it as about 11% to 13% growth. And that's from a combination of membership and ARM growth. The majority of growth next year, we expect to be membership-driven growth. It's from the full year impact of this year's strong net adds plus solid paid net adds expected next year.

We still have hundreds of millions of households that aren't members, and we'll grow into that opportunity, thanks to a great '25 slate and our improvements in converting consumer demand. And we will have our growth. ARM's a combination of continued plan evolution and pricing, building off the actions we've been taking this year and growing our ads revenue, as Greg just talked about, not yet a primary growth driver but to be a more meaningful contributor in '25. So overall, healthy double-digit revenue growth, more balanced across multiple drivers and strong outlook.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Spence. Building on that question from Justin Patterson at KeyBanc, given what appears to be a moderating competitive environment, how are you thinking about the puts and takes around operating margins going forward?

Spencer Adam Neumann

Chief Financial Officer

Sure, I'll take it again. So as we said in the letter, we see plenty of room to increase our margins over the long term. And we feel great about what we're delivering in '24. We expect to be up 6 percentage points, as Ted mentioned, and our approach to margin is unchanged. We believe we build a stronger and more lasting business by gradually increasing margins as we grow.

We set margin targets, and we do that by investing to improve our service while making trade-offs and prioritizing like growing our costs slower than revenue and operating like owners. The amount of margin growth each year, it will bounce around a bit based on the strategic opportunities in a given year, FX moves and things like that, but we'll aim to increase each year. And what you see in our '25 guide is consistent with that approach.

So coming off such a big year of margin expansion in '24, which exceeded our target, we want to be sure we're actively investing to deliver more value to our members and strengthen and grow our business. So the things you just heard about from Greg and Ted, further investing in our core film and TV offering, improving product discovery, expanding into new areas like live and ads and games. So we think this strikes the right balance for our '25 kind of planning with lots of room to grow profit margin and absolute margin dollars for many, many years to come.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Spence. We have a specific question on our Q4 results that I think is worth touching on from John Blackledge of TD Cowen. Perhaps Spence and Ted, you could tag team on this one. Could you please discuss the dynamics that drove the slight LatAm member net loss in Q3 and provide further color on drivers of the pickup in LatAm early in Q4?

Spencer Adam Neumann
Chief Financial Officer

Sure, Ted. I can start off, if you like.

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

Yes, sure.

Spencer Adam Neumann
Chief Financial Officer

Okay. Overall, the underlying business trends in LatAm are healthy. Q3 revenue, which is our primary kind of North Star for top line growth, was up 9% year-over-year. Year-to-date, it's up 10% on a reported basis. That's in line with our 2023 growth of 9%, and we've got much more significant currency headwinds in '24 relative to '23. So actually, growth at the local level is much accelerated in '24 relative to a year ago.

On Q3 membership specifically, the slight decrease you saw was primarily due to some recent price changes in some of our bigger LatAm markets, which always dampens near-term member growth. But the good news is we're already seeing a nice rebound so far in Q4. LatAm memberships are growing nicely in the fourth quarter -- early in the fourth quarter. And fun fact, if the quarter lasted 1 more day, net adds would have been up instead of down. So overall, we feel good. And maybe, I don't know, Ted, if you want to speak to it a bit more.

Theodore A. Sarandos
Co-CEO, President & Director

No, I'd just say we obviously don't time those things for quarter ends. The thing that really we're really excited about in Q4 in Latin America is this incredible slate upcoming. They've got Senna from Brazil, which is going to be -- we think it's going to be a large hit around the world, but most importantly, loved in Brazil. A Hundred Years of Solitude from Colombia. Rodrigo Prieto is making his directorial debut on a new film for us in Mexico called Pedro Páramo, which is an epic book in Mexico that's being adapted. So we're really thrilled with the creative output in Latin America. And as Spence alluded to here, we're also thrilled with the underlying business climate, too.

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

Great. I'll now move us on to a series of questions about advertising, and we'll begin with a question from Steve Cahall of Wells Fargo. Can you please discuss the levers that will move advertising to a more -- to a primary contributor to growth after 2025? How is ad tier engagement tracking versus ad free? What kind of CPMs are you attaining in the U.S. market? And how should we think about improvements in terms of your ability to monetize your advertising inventory?

Gregory K. Peters
Co-CEO, President & Director

Okay. There's a lot there. We'll see if we can't take them all on. I would say the most important part is we've been carrying 2 top-level priorities when we think about our ads business. Priority #1 was we have to grow our ad tier membership so that we can get to sufficient scale to be relevant in each market for advertisers. And the big priority #2 is we have to improve our capabilities and attractiveness to advertisers and therefore the monetization of all that inventory.

So on that first one, we've made some really solid progress. Q3, we mentioned in the letter, ads plan accounted for over 50% of sign-ups in our ads countries. That's a leading indicator about how you think about sort of ads membership there. Our ads plan membership base was up 35% quarter-over-quarter. That's over probably 4 quarters of really significant growth as well. So that's growing nicely.

As we said last quarter, we expect to be at critical scale as our advertising partners tell us they need us to be in each of our 12 ads countries in 2025. And engagement that was mentioned, that remains healthy. Our ads plan members are watching similar amount of

view hours and similar titles, too, which is probably interesting to note, relative to comparable non-ads plan members. So this was our top area of improvement. I'm incredibly proud of the significant progress that our teams have been able to deliver on that front.

And because they've been able to do that, that allows us to turn more attention to our second priority, and that's effectively monetizing all that growing inventory. I think it's worth noting we've got a lot of work still ahead of us to achieve that goal, to make our offering better for advertisers. It's going to be a priority for us for several years coming, but we're moving.

Our first-party ad server, which is a key component of unlocking value in the space, that's on track to launch in Canada this quarter and then the rest of our ad markets in 2025. We've got our partnerships with Trade Desk and Google Live, and those are going well. We've got a road map for more formats, for more features, for more measurement. That's all coming. So while we've got lots of work to do, we are very confident in our ability to execute and grow our ad business much like we did with the paid sharing initiative.

Theodore A. Sarandos

Co-CEO, President & Director

Could I just follow up on Greg for a second? Obviously, the teams are making great progress. We have a ton of work to do. And it's seemingly new to us, but what's great about it really is that it calls on all of our deepest skill sets, both technologically and creatively. It depends heavily on thrilling engagement, which is true for both of our subscription business and our ad business.

So what advertisers want to do is they want to be close to the stories that people are watching, the stories that people are talking about, the events that people are gathering to be part of. That's all part of the exact same equation. So when we have a Nobody Wants This or a Perfect Couple, that fandom, that buzz, that's what advertisers want to be close to, and that's why I'm excited about what we're doing here.

Gregory K. Peters

Co-CEO, President & Director

Yes, and I think that's right. And stepping back and sort of just putting that into broader context, our goal over the next 5 or 10 years is to combine the best of digital advertising. So this is all the things that we know from that targeting, personalization, relevance with the best of TV advertising. So this is an elevated creative format. We've got highly engaged viewers and positioned against those culture-defining shows and films that Ted mentioned.

And so that's really the North Star. We see ads revenue growth on a good trajectory. We've got healthy CPMs at the high end of that premium CTV ad market. That's where we want to be positioned. And while ads won't be a primary driver of revenue in 2025, because we're still scaling that audience and that inventory faster than our ability to monetize it, we definitely see already the momentum growth in the monetization and our opportunity to close that gap.

So for 2025, we expect that ads revenue will roughly double year-over-year, albeit off a small base. But just as a confidence point in that, this year's U.S. upfront, we're seeing 150% -- over 150% increase in our ads sales commitments. So I think it's also worth noting that like ads against premium video, it's a proven model. So if we take the potential size of that opportunity, the growth trajectories that we are seeing, that's what makes us so excited about ads being able to be one of those growing levers to support our sustaining healthy revenue and profit growth in the years to come.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Great. Thank you, Ted and Greg. We do have some questions about ad tech, probably in 2 parts. First, from Justin Patterson at KeyBanc. What are your initial learnings from your partnerships with The Trade Desk and DV360? And secondly, from Rich Greenfield. Netflix has decided to use Trade Desk to build demand. But longer term, how important do you see partnerships like Trade Desk versus building your own walled garden?

Gregory K. Peters

Co-CEO, President & Director

A couple of parts there. So I'd say these partnerships are going well. We're live both with one-to-one private marketplaces in UCAN and LatAm. We've got some always-on agency deals in the U.S. and Australia. We're going to be adding more programmatic capabilities next month in UCAN and LatAm and just sort of building from there. So that's what gives you a sense of the road map.

What have we learned? I'd say not surprisingly that more demand creates positive pressure on CPMs. More channels mean it's easier for more clients to buy. So we're learning, I think, what you'd expect to learn. As we mentioned previously, just this last question, we're seeing a solid trajectory on ads revenue growth. And this is going to be part of how we build that trajectory over time.

But it's going to take us a while to catch up to that significant inventory expansion we've been able to drive. But I really see that as growth potential that we're building in, right? So we're going to progressively work our way into that inventory and effective monetization of that inventory over the next several years. And the good news is like we've got a long road map of things that we know will make our ads more valuable. So we're excited about that.

As to Rich's walled garden question, I would say we've learned not to be too rigid in our position. So we're going to always evaluate and will evolve based on how our business is evolving and, frankly, how the ecosystem is evolving around us. But we believe these partnerships are very positive for us.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Greg. I will move us on now to a few questions on content and engagement from Ben Swinburne of Morgan Stanley, and this is for Ted. How did last year's Hollywood strikes impact your 2024 slate and ultimately engagement and retention? And did it disproportionately impact UCAN given a shutdown production here in the States? At what point, if not already, will you be back to a more normalized slate with no lingering effects of the strikes?

Theodore A. Sarandos

Co-CEO, President & Director

Thanks, Ben. Look, our aim here is to always have a very steady drumbeat of great new TV shows and films and games for our members to watch throughout the year. So a drumbeat so steady that when you're watching the last episode of whatever you're watching, you start expecting the next thing to be great, too.

However, in the first half of this year, our lineup was much lumpier than we liked. And it was -- and that was primarily because of the work stoppage. It did hit UCAN the hardest, but there were some effects of that felt in production around the world. We're moving closer and closer to a more normalized output schedule now. Series a little more on track than film, but neither fully, fully recovered.

We've had returning favorites like Bridgerton that managed to get into the first half of the year, but many of our other high-profile returning hits like Cobra Kai, Emily in Paris, Outer Banks and even our new shows like Perfect Couple and Nobody Wants This were scheduled for much earlier in the year and got in kind of late in Q3. And that delay was again because of the strike and its impact on the UCAN slate. By the end of Q3, a lot more normalized as you see. Perfect Couple, Monsters, Nobody Wants This, Accident, that nice, steady drumbeat that we keep -- we're trying to hit on all the time.

Our film slate, obviously, was impacted as well, and it's getting back to normal. We also had a change in the leadership there, which changed the cadence of release a bit. We have a really strong Q4 lineup coming up with Carry-On, Piano Lesson, Spellbound, Six Triple Eight, Emilia Pérez, and things are getting much steadier. In 2025, we're largely back to normal. I mentioned earlier about new Knives Out film, Guillermo del Toro's Frankenstein, Happy Gilmore 2, a new film from the Russo brothers with Millie Bobby Brown, Electric Street (sic) [Electric State]. I mean a lot of -- and plenty more on top of that, but largely back to normal starting in '25.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Awesome. Thank you, Ted. The next question comes from John Hodulik of UBS. The Nielsen Gauge indicates that U.S. engagement for Netflix has been stable recently. That's his nice way of saying flat, I think. With paid sharing now on the run rate, when can U.S. engagement begin to grow again? Do you see expansion into live programming as a major driver?

Theodore A. Sarandos

Co-CEO, President & Director

Well, look, total hours were up roughly 1% in the first half of the year compared to the same period last year. Engagement is super healthy. I mentioned earlier 2 hours per day per member and then owner household engagement, which is much more of an apples-to-apples comparison of -- account sharing is up, and we're very happy with that.

The contribution from live, you have to think about it this way. We have about 200 billion hours every year on Netflix. Very few of them are actually live, but they all promise to be extremely high value. So the excitement of the Tyson-Paul fight, which is growing

every day. And certainly, Christmas Day NFL football is going to be a blast all day on Netflix. So we're really excited that we're going to be capturing even more of the excitement that comes when the whole world gets together to watch something, and that's really fun part of live.

The contributor to growing engagement is going to be across the board on our scripted and unscripted or documentary programming, all the kind of things that people love, including now the addition of some live hours. Greg mentioned earlier, but weekly live with WWE and the new John Mulaney show upcoming but then a steady cadence of exciting events more and more upcoming. But pretty hard to swamp the on-demand hours, which I said are over 200 billion. But thankfully, all hours are not created equal.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Ted. From Rich Greenfield, we have the perennial question on theatrical, which is, is it possible for films to pierce the cultural zeitgeist without a theatrical release? So over to you, Ted.

Theodore A. Sarandos

Co-CEO, President & Director

Thanks again for that question again, Rich. Look, I'm just going to reiterate, we are in the subscription and entertainment business. And you can see in our results it's a pretty good business, and it appeals to a very large segment of consumers and fans. Our top 10 films that premier on Netflix all have over 100 million views, among the most watched films in the world.

It's our desire to kind of keep adding value to our consumers for their subscription dollar. We believe that not making them wait for months to watch the movie that everyone's talking about adds that value. So what we do for filmmakers is we bring them the biggest audience in the world for their films. And then we help them make the best films of their life. That could be any 1 of the 9 best picture nominee films that we've released so far or it could be any of those top 10 films that are as big as billion-dollar box office movies. So I'm sure that we can continue to pierce the zeitgeist and have those moments in the culture even when those moments begin on Netflix.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Ted. Last question on content from Alan Gould of Loop Capital, which is will you -- are you planning to change the talent compensation structure to pay less upfront and more on the back end based on success?

Theodore A. Sarandos

Co-CEO, President & Director

Thank you for that. Look, we like our model and talent likes our model. It's so much more impactful for our business if we can make our films, our shows just a little bit better, so much more impactful than making them a little bit cheaper. Bela said this very clearly a couple of weeks ago to all the talent agencies. We're not changing our compensation structure.

Paying upfront, something that Netflix actually pioneered, benefits creators and it benefits Netflix. So for creators, Netflix takes all the financial risks so that they can focus on making the best possible version of what they're working on. And for Netflix, that model enables us to attract the best talent in the world. Now with all that said, we have been and we continue to be and we are open to more bespoke deals where talent is interested. Now they rarely happen because typically the talent chooses the upfront model. So we think that we have the right model, and we are not looking to change it.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Ted. I'll now move us along to the next topic, which is around pricing and plans. This one comes from Rich Greenfield of LightShed. And the question is, what is holding you back from raising price into one of the strongest content periods in recent memory starting in late Q4 this year and into 2025? Greg, did you want to take that one?

Gregory K. Peters

Co-CEO, President & Director

Sure. We're going to invite Rich to join our pricing committee. I think it's worth starting by just noting that our approach towards pricing, it hasn't changed. It's been remarkably consistent over many, many years. And our core theory is that we got to work really, really hard to make sure that we are delivering more value to members every quarter. And then we sort of assess based on how that's

going, metrics like engagement, like acquisition and retention. Did we do a good job there, how we actually deliver on that promise of more value?

And when we do, then we occasionally ask members to pay a bit more so we can invest that forward and keep that whole process going. So you've seen us do that this past quarter in a couple of countries. We did it in Europe in several countries. We did it in Scandinavia. We did it in Japan. I'd say those changes that we've done have been going well. The results have been in line with expectations.

You saw in the letter that we announced that we're doing it in Spain and Italy as well. And of course, we'll continue to evaluate that. We'll look at those signals and we'll figure out where and when we think it's appropriate to ask those members to pay a little bit more as well.

And I would say just stepping back, we look at the long-term monetization opportunity, and we feel that there's a tremendous amount of potential there as long as we can continue to deliver on improving the variety and quality of our TV and film slate, you've heard a lot about that and what we're excited about over the next year to come, as well as expand our offering into new areas. We've got the live events, Tyson-Paul, Christmas Day NFL. Those should be exciting things. And then games. So if we do a good job there, then we feel like we can continue to keep that long-term monetization cycle flowing.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thanks, Greg. From Robert Fishman of MoffettNathanson. You've increased prices for your non-ads plans but have kept the ad tier at the same lower price while other streaming services have been increasing prices on both. How do you think about the right spread between the ad tier and the non-ad tiers?

Gregory K. Peters

Co-CEO, President & Director

Yes. We try to think about our pricing mostly not in relationship to competitors but from the value that we're delivering to members. So we want to have a range of price points. We think that that's healthy. We want to have that range of price points to be able to deliver different features for different consumers while also making sure that we're not adding too much complexity or too much choice tax, which we think is a real thing.

And the other thing that I think is important to note here is that our North Star through this process is optimizing long-term revenue rather than ARM. We look at a variety of signals to sort of help assess how we're doing in that regard. An important one is the relative balance of sign-up mix across these various options. That's sort of an indicator of healthy offering. I think it's also important to say that we love the low price point and increased accessibility that comes with our ad plan.

If you take the U.S., just as an example, \$6.99, I think it represents an incredible value. You get an amazing offering of TV shows, films and games, 2 streams, HD plus downloads. That's an exciting part of that plan. So I'd say with all of that in mind, we'll continue to evaluate based on those factors. We'll continually try to offer consumers a spread of plan choices, the right features at the right price point and evaluate that and evolve it based on what we think works.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thanks, Greg. From Doug Anmuth of JPMorgan. He's asking about the phasing out of the Basic plan across the U.K., Canada, U.S. and France. Are there any sort of learnings you can share there? And any expectations to phase out Basic in other ad markets going forward?

Gregory K. Peters

Co-CEO, President & Director

Yes. I think it's a good example of what I just mentioned before, how we sort of continue to evolve plans and pricing, thinking about expanding that range, especially the low end on our ads plan, but also keeping the number of choices manageable. And I think of this as that every plan has to earn its spot on the roster, right? It has to deliver enough value to consumers in that offering. Otherwise, it just sort of adds to the complexity and choice tax.

I think what we've done in this regard is also a good example about how we generally try out changes and judge by how consumers react, whether or not that change makes sense for the business. So I'll let our actions speak for themselves. The change has gone well,

in line with our expectations. We announced one more country we'll do that in, in the letter and then nothing more to say on it beyond that.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thanks, Greg. Spence has been a bit quiet, so I'll now ask him a question from Ben Swinburne of Morgan Stanley on capital allocation. Spence, the company looks poised to generate tens of billions in free cash flow over the next several years. What are the possible uses of all this capital? Will you look to maintain a minimum net leverage level?

Spencer Adam Neumann

Chief Financial Officer

Sure, I'll get into it. I was actually just -- I was quiet because I was reflecting on getting off the pricing committee so that Rich could get on it, but I think the team would welcome that. In terms of kind of future free cash flow, well, that future of throwing off tens of billions of free cash flow, that will be a great future. It would be a nice challenge to have. But no change to our capital allocation policy.

We prioritize profitable growth by reinvesting in our business. Maintain ample liquidity, second priority. And then we return excess cash to shareholders beyond several billion dollars of minimum cash that we have on our balance sheet and then any that we use for selective M&A. But beyond that, we return to shareholders through share repurchase.

We have made some tactical moves recently, consistent with our policy. We upsized our revolver to \$3 billion for additional liquidity if we need it on a rainy day. And we raised \$1.8 billion of investment-grade debt earlier in the quarter to refinance upcoming '25 maturities. But no plans to increase leverage to buy back stock or to issue a dividend. We put a real premium on balance sheet flexibility. So in other words, to be clear, no minimum leverage targets.

Spencer Wang

Vice President of Finance, Corporate Development & Investor Relations

Thank you, Spence. Now the next question comes from John Hodulik of UBS. It's regarding YouTube. Do you see YouTube's growing share of TV consumption as friend or foe? Is user-generated content via AI a threat to your business?

Theodore A. Sarandos

Co-CEO, President & Director

Let me take AI. Let's take the second one first on the AI side. Lots of hype, good and bad, about how AI is going to impact or transform the entertainment industry. I think that the history has been that entertainment and technology have worked hand-in-hand throughout the history of time. And it's very important, I think, for creators to be very curious about what these new tools are and what they could do.

But AI needs to pass a very important test. Actually, can it help make better shows and better films? That is the test and that's what they got to figure out. But I've said this before and I will say it again. We benefit greatly from improving the quality of the movies and the shows much more so than we do from making them a little cheaper. So any tool that can go to enhance the quality, making them better is something that is going to actually help the industry a great deal.

When I look at YouTube specifically, I'd say look, we compete directly with YouTube for people's time, for the time they spend on that TV screen. But we have very different strengths. And we continue to invest in ambitious premium content to grow our share of engagement. We think that Netflix is the best place for premium stories because we're the home to the best storytellers. We have an enormous reach, 600 million watchers. We assume the financial risk when you're making your content. Our subscription model generates higher returns for creators. Those higher returns let them make more ambitious investments in their next projects.

So Netflix and YouTube, while we do compete for that time, we're interestingly complementary as well. So we put up our trailers on YouTube, and they get a lot of viewing, which is great because it drives a lot of viewing on Netflix. So we think among those advantages that we have here is that streaming is the future. It's what consumers want. We give that to consumers. We give them choice and control. We have that enormous reach that we talked about. So you're looking at really incredible watching, incredible fandom. We continue to lead the industry in engagement.

And the other investment we have is benefits for consumers because it brings a great deal of value for money. Creators get big audiences on both platforms. But when you look at it and say, how do you do all this and how do I get the best return, we like where

we sit. And we think it also brings great value to shareholders because you get higher revenue and profit. Greg, do you want to jump in on either of those or both?

Gregory K. Peters
Co-CEO, President & Director

Yes, maybe just to reiterate, I think, the core message. I think that Netflix fulfills an important and different role for both consumers who want these great movies and TV shows but also for creators who want partners that can share in the risk that's inherent to bringing those stories to life.

And if you think about some of the titles we'll launch this quarter, you mentioned a couple: Squid Game, Outer Banks, Black Doves. You mentioned A Hundred Years of Solitude, Senna, both coming from Latin America, which are huge, ambitious projects. It's hard to imagine how those kind of big creative bets would be possible with YouTube's model. So while it's certainly a competitive environment, that's absolutely true, but we feel our focus and our model, which is the best storytellers, ambitious premium storytelling, those work well for consumers and for creators while also generating significant operating margin for the business, too.

Theodore A. Sarandos
Co-CEO, President & Director

Yes. And like we said last quarter as well, we are really focused on the 80% of watching that happens not on YouTube or Netflix yet. So we got a lot of -- we still got plenty of work to do.

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

Thank you, Ted and Greg. We have time for one last question, and this one comes from Michael Morris of Guggenheim. His question is Netflix doesn't need to bundle with other streaming services, but could there be an opportunity to leverage your industry-leading global member base, be it offering a bundle with a less scaled streamer, potentially one or more services with complementary content like live sports and in exchange for a share of subscription economics or advertising inventory?

Theodore A. Sarandos
Co-CEO, President & Director

Yes. So look, we're seeing a lot of our competitors use bundles to find growth in their businesses, and I get that. It's a comfortable business model for legacy media companies. And kind of given the narrow scope of the libraries on these services and the fairly limited engagement, it makes sense for them to kind of replicate some of the older media models of kind of creating these bundles.

But what we're focused on is adding more and more value to this package, amazing series and films and now games at a remarkably low price all in one place. We have first-run films. We have a variety of original series from all over the world that are the most watched and the most talked-about shows. And you don't have to go anywhere else if you also want unscripted shows and competition shows and great animated series and great animated films, the best of stand-up comedy and increasingly, buzziest live events on TV, things like the Brady Roast or the Tyson-Paul fight or NFL football on Christmas Day or next year with the WWE. So we are really betting on our ability to reach consumers and on our ability to continue to grow value of this package.

Gregory K. Peters
Co-CEO, President & Director

Yes, I think that's right. And it's worth noting that our share of viewership in even our biggest countries is still less than 10% of TV time. So we look at this as there's a huge opportunity to grow that share by doing what Ted said, invest more in our slate, continue to improve the variety and quality of our offering.

I think it's also worth noting that we've got a lot on our plate right now. We've got a lot of hard work building new capabilities. We're building ads. We're building games. We're building live. Those all expand that offering. They deliver more value to members. So we want to focus on building those capabilities. And before we're taking on anything new, let's take care of that. And I think we believe strongly based on our history that if we can just keep focusing on that, be a little bit better every day at delivering more entertainment value to our members, we're going to have an incredible business. So let's stay focused there.

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

Great. Thank you, Ted and Greg and Spence, for your answers on this call. Thank you, analysts, for your questions, and we thank all the listeners for tuning into our quarterly earnings call. And we look forward to speaking with you all next quarter. Thanks again.

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