

# Overview of Content Accounting

| Investor Relations  
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# Disclosure

This presentation is intended to provide additional information to investors on certain accounting matters. This information should be considered in addition to, not as a substitute for or superior to the disclosure contained in our filings with the Securities and Exchange Commission. You should read this discussion in conjunction with the condensed consolidated financial statements and the notes thereto included in our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K.

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# Overview.

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# Streaming content accounting standards.

We use two accounting standards for our streaming content costs. Since we launched streaming in 2007, we have used the guidance of **ASC 920: Entertainment - Broadcasting** because we started the streaming service with content that we license (rather than own).

- We license both Netflix originals (such as *House of Cards* and *Orange is the New Black*) as well as 2nd run titles, such as *Shameless* and *How to Get Away with Murder*

Beginning in 2016, we also now apply the guidance of **ASC 926: Entertainment - Films** for the original content that we self-produce and where we own the intellectual property.

- We believe the benefits of self-producing content include lower costs (no studio middle-man), ownership of the intellectual property, which allows us to potentially monetize in different ways (eg, licensing & merchandising) and greater rights flexibility (global rights, exclusivity)

In Q1'19, we early-adopted the update (**ASU 2019-2**) to accounting standards for ASC 920 and 926. There was no material impact as our accounting policies are already consistent with the new rules.

# Examples.

	Netflix Originals (Branded)		2nd Run movies & TV shows
Type of content	Owned	Licensed	Licensed
Examples	<i>Stranger Things, Mindhunter, Dave Chappelle, Ingobernable, Bird Box, Dark, Sacred Games, Big Mouth, Godless, Nailed It!, The Irishman, The Witcher</i>	<i>House of Cards (MRC), Orange is the New Black (Lionsgate), Narcos (Gaumont), The Crown (Sony), 13 Reasons Why (Paramount)</i>	<i>Shameless (Showtime), How to Get Away with Murder (ABC), The Office (Universal), The Godfather (Paramount)</i>

# Amortization methodology.

- The amortization schedule for content is based on historical and estimated viewing patterns and is reviewed quarterly
- Our content library is **amortized on an accelerated basis**
- Content assets are amortized over the shorter of the title's window of availability or estimated period of use or 10 years
- On average, **over 90% of a licensed or produced streaming content asset is expected to be amortized within four years after its month of first availability.**
- First run topical programming like talk shows are expensed upon airing

# ASC 920: Entertainment - Broadcasters.

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# Criteria for ASC 920.

**ASC 920** specifies that a broadcaster shall account for a license agreement for program material as a **purchase of rights**

Under ASC 920, the following **3 criteria** must be met in order for the content we license to qualify for asset recognition:

- The cost of each title is known or reasonably determinable
- The title (source file) has been received
- The title is available for first showing

# ASC 926: Entertainment - Films.

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# We use ASC 926 for produced assets.

For content that we produce, we capitalize the costs associated with production, including development cost, direct costs and production overhead. These amounts and licensed content are now included in "Non-current content assets, net" in our balance sheet, in accordance with ASU 2019-2.

	As of December 31,	
	2019	2018
	(in thousands)	
<b>Licensed content, net</b>	\$ 14,703,352	\$ 14,081,463
<b>Produced content, net</b>		
Released, less amortization	4,382,685	2,403,896
In production	4,750,664	3,305,126
In development and pre-production	667,866	311,842
	9,801,215	6,020,864
<b>Total</b>	<b>\$ 24,504,567</b>	<b>\$ 20,102,327</b>
<b>Current content assets, net</b>	\$ —	\$ 5,151,186
<b>Non-current content assets, net</b>	\$ 24,504,567	\$ 14,951,141

# Financial statements.

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# Content accounting in our financials.

## Balance sheet

- Total cost of titles is recorded as assets in content assets
- Total unpaid cost of titles is recorded as a liability

## Income statement

- The asset is amortized over the shorter of the title's window of availability or useful life
- Amortization expense is recorded in cost of revenue

## Cash Flow Statement

- Additions to streaming content assets = total gross additions (not cash paid)
- Change in streaming content liabilities = net change in liabilities resulting from payments and asset additions, both current and non-current
- Amortization of streaming content assets = adjusts for the non-cash expense included in net income

# Balance Sheet.

As of December 31,

	2019	2018
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 5,018,437	\$ 3,794,483
Current content assets, net	—	5,151,186
Other current assets	1,160,067	748,466
Total current assets	6,178,504	9,694,135
Non-current content assets, net	24,504,567	14,951,141
Property and equipment, net	565,221	418,281
Other non-current assets	2,727,420	910,843
Total assets	\$ 33,975,712	\$ 25,974,400
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current content liabilities	\$ 4,413,561	\$ 4,681,562
Accounts payable	674,347	562,985
Accrued expenses and other liabilities	843,043	481,874
Deferred revenue	924,745	760,899
Total current liabilities	6,855,696	6,487,320
Non-current content liabilities	3,334,323	3,759,026
Long-term debt	14,759,260	10,360,058
Other non-current liabilities	1,444,276	129,231
Total liabilities	26,393,555	20,735,635
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 10,000,000 shares authorized at December 31, 2019 and 2018; no shares issued and outstanding at December 31, 2019 and 2018	—	—
Common stock, \$0.001 par value; 4,990,000,000 shares authorized at December 31, 2019 and December 31, 2018, respectively; 438,806,649 and 436,598,597 issued and outstanding at December 31, 2019 and December 31, 2018, respectively	2,793,929	2,315,988
Accumulated other comprehensive loss	(23,521)	(19,582)
Retained earnings	4,811,749	2,942,359
Total stockholders' equity	7,582,157	5,238,765
Total liabilities and stockholders' equity	\$ 33,975,712	\$ 25,974,400

All content assets including produced assets and available licensed assets are included in Non-current content assets, in accordance with ASU 2019-2, as of Q1'19

Content payments due within 12 months

Content payments due > 1 year

# Income Statement.

	Year ended December 31,		
	2019	2018	2017
Revenues	\$ 20,156,447	\$ 15,794,341	\$ 11,692,713
Cost of revenues	12,440,213	9,967,538	8,033,000
Marketing	2,652,462	2,369,469	1,436,281
Technology and development	1,545,149	1,221,814	953,710
General and administrative	914,369	630,294	431,043
Operating income	2,604,254	1,605,226	838,679
Other income (expense):			
Interest expense	(626,023)	(420,493)	(238,204)
Interest and other income (expense)	84,000	41,725	(115,154)
Income before income taxes	2,062,231	1,226,458	485,321
Provision for (benefit from) income taxes	195,315	15,216	(73,608)
Net income	\$ 1,866,916	\$ 1,211,242	\$ 558,929
Earnings per share:			
Basic	\$ 4.26	\$ 2.78	\$ 1.29
Diluted	\$ 4.13	\$ 2.68	\$ 1.25
Weighted-average common shares outstanding:			
Basic	437,799	435,374	431,885
Diluted	451,765	451,244	446,814

Content amortization included in cost of revenue and broken out in our cash flow statement

# Amortization expense disclosure.

	Year ended December 31,		
	2019	2018	2017
	(in thousands)		
Licensed content	\$ 7,242,799	\$ 6,511,689	\$ 5,680,373
Produced content	1,973,448	1,020,399	517,444
Total streaming content	\$ 9,216,247	\$ 7,532,088	\$ 6,197,817



# Cash Flow Statement.

	Year Ended December 31,		
	2019	2018	2017
<b>Cash flows from operating activities:</b>			
Net income	\$ 1,866,916	\$ 1,211,242	\$ 558,929
<b>Adjustments to reconcile net income to net cash used in operating activities:</b>			
Additions to streaming content assets	(13,916,683)	(13,043,437)	(9,805,763)
Change in streaming content liabilities	(694,011)	999,880	900,006
Amortization of streaming content assets	9,216,247	7,532,088	6,197,817
Depreciation and amortization of property, equipment and intangibles	103,579	83,157	71,911
Stock-based compensation expense	405,376	320,657	182,209
Other non-cash items	228,230	81,640	117,864
Foreign currency remeasurement loss (gain) on long-term debt	(45,576)	(73,953)	140,790
Deferred taxes	(94,443)	(85,520)	(208,688)
<b>Changes in operating assets and liabilities:</b>			
Other current assets	(252,113)	(200,192)	(234,090)
Accounts payable	96,063	199,198	74,559
Accrued expenses and other liabilities	157,778	150,422	114,337
Deferred revenue	163,846	142,277	177,974
Other non-current assets and liabilities	(122,531)	2,062	(73,803)
Net cash used in operating activities	(2,887,322)	(2,680,479)	(1,785,948)

Includes content amortization from P&L

Gross additions to content library

Change in content liabilities (ST & LT)

Streaming content amortization

# Streaming Content Obligations.

Streaming content obligations include amounts related to the acquisition, licensing and production of streaming content. An obligation for the production of content includes non-cancelable commitments under creative talent and employment agreements, as well as other production related commitments. An obligation for the acquisition and licensing of content is incurred at the time we enter into an agreement to obtain future titles. Those that are not reflected on the balance sheet do not yet meet asset recognition criteria (see **slide 9**)

- Either will never meet asset recognition criteria because cost per title is unknown or
- Cost per title is known but titles are not yet available for showing
- These obligations reflect content costs that will be recorded to the income statement in the future once the 3 criteria for ASC 920 are met
- ESPN and Fox have similar obligations related to their sports programming commitments

Contractual obligations (in thousands):	Payments due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Streaming content obligations (1)	\$ 19,490,082	\$ 8,477,367	\$ 8,352,731	\$ 2,041,340	\$ 618,644

# Streaming Content Obligations.

- Certain agreements include the obligation to license rights for unknown future titles, the ultimate quantity and/or fees for which are not yet determinable as of the reporting date and are not included in streaming content obligations. Traditional film output deals or certain TV series license agreements where the number of seasons to be aired is unknown, are examples of these types of agreements.
- These unknown obligations are expected to be significant and we believe could include approximately \$1 billion to \$4 billion over the next three years, with the payments for the vast majority of such amounts expected to occur after the next twelve months. Once we know the title that we will receive and the license fees, we include the amount in the contractual obligations table.

# Impact on Cash Flow.

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# Cash costs for original content are more front end loaded.

- For produced original content, we often cash flow the production costs during the content creation process prior to completion and release on the Netflix service. This could be years in advance of a release date.
- This also creates a content asset with a useful life well into the future.
- For licensed originals, cash payment terms also generally exceed expense in the early years.
- Payment for second window and catalog licensed content is generally upon delivery and over the window of availability.

# Frequently Asked Questions (FAQ).

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# FAQ.

## **You have discussed your ratio of cash spending on content to P&L spending on content. What does this refer to?**

- This ratio is our cash spending on content (as derived from our cash flow statement) divided by our content amortization (which flows through our income statement)
- This ratio is an indicator of the timing differences between cash payment terms on content vs. the content expense recognition
- Cash payments are more front end loaded, especially for produced content which we must fund during the production process before the content is completed and available for viewing

# FAQ (continued).

## How do I calculate your cash spending on content?

- Cash spending on content can be derived from our cash flow statement. The sum of Additions to Streaming Content Assets and the Change in Streaming Content Liabilities equates to our cash spending on streaming content

	Year Ended December 31,		
	2019	2018	2017
<b>Cash flows from operating activities:</b>			
Net income	\$ 1,866,916	\$ 1,211,242	\$ 558,929
<b>Adjustments to reconcile net income to net cash used in operating activities:</b>			
Additions to streaming content assets	(13,916,683)	(13,043,437)	(9,805,763)
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Amortization of streaming content assets	9,216,247	7,532,088	6,197,817

~\$14.6 bil. in cash spent on streaming content in FY19 vs. \$9.2 bil. in content amortization, resulting in a 1.6x ratio of cash spend on content to P&L content spend ratio



# FAQ (continued).

**Can I divide your content amortization by your content library to derive an indication of your average amortization term or changes in your amortization schedules?**

- No, because our content library is presented net of amortization, not on a gross basis
- In addition, content is amortized on an accelerated basis
- Our amortization in any given period is also affected by the mix of content as different categories of content are amortized on different schedules (based on historical and estimated viewing patterns)

# FAQ (continued).

## **What is your process for determining possible impairment of your content library?**

- Content assets (licensed and produced) are predominantly monetized as a group and therefore are reviewed at a group level when an event or change in circumstances indicates a change in the expected usefulness of the content or that the fair value may be less than unamortized cost.
- We also review at a title level if a specific title is pulled down permanently or expected to be abandoned.
- Content assets will be stated at the lower of unamortized cost or fair value if an impairment is identified.

# FAQ (continued).

## **Are there other non-amortization content costs in cost of revenue on your income statement?**

- Yes, our cost of revenues also include other content costs that are not classified as amortization.
- These costs include content personnel costs, portions of our overall deals with certain content creators, music rights and miscellaneous expenses related to production.
- In addition, other cost of revenue include streaming delivery expenses and other operating costs like payment processing and customer service and other costs involved in making our content available to members

**Thank you.**

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