

# Overview of Content Accounting

| Investor Relations  
July 2022

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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.

# Contents.

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ASC 926: Entertainment - Films
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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 *Ozark* 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 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, Dave Chappelle, Ingobernable, Bird Box, Dark, Sacred Games, Big Mouth, Bridgerton, Nailed It!, The Irishman, The Witcher, The Queen's Gambit</i>	<i>Ozark (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), Grey's Anatomy (Disney), The Godfather (Paramount)</i>

# Amortization methodology.

- The amortization schedule for content is based on historical and estimated viewing patterns and is reviewed quarterly.
- **All titles** in our content library are **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 launch.**
- First run topical programming like talk shows are expensed upon airing.

**ASC 920: Entertainment -  
Broadcasters &  
ASC 926: Entertainment -  
Films**

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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

# 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,	
	2021	2020
	(in thousands)	
Licensed content, net	\$ 13,799,221	\$ 13,747,607
Produced content, net		
Released, less amortization	6,877,743	5,809,681
In production	9,235,975	4,827,455
In development and pre-production	1,006,600	999,207
	17,120,318	11,636,343
Content assets, net	\$ 30,919,539	\$ 25,383,950

# 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,	
	2021	2020
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 6,027,804	\$ 8,205,550
Other current assets	2,042,021	1,556,030
Total current assets	8,069,825	9,761,580
Content assets, net	30,919,539	25,383,950
Property and equipment, net	1,323,453	960,183
Other non-current assets	4,271,846	3,174,646
Total assets	<u>\$ 44,584,663</u>	<u>\$ 39,280,359</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current content liabilities	\$ 4,292,967	\$ 4,429,536
Accounts payable	837,483	656,183
Accrued expenses and other liabilities	1,449,351	1,102,196
Deferred revenue	1,209,342	1,117,992
Short-term debt	699,823	499,878
Total current liabilities	8,488,966	7,805,785
Non-current content liabilities	3,094,213	2,618,084
Long-term debt	14,693,072	15,809,095
Other non-current liabilities	2,459,164	1,982,155
Total liabilities	28,735,415	28,215,119
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 10,000,000 shares authorized at December 31, 2021 and December 31, 2020; no shares issued and outstanding at December 31, 2021 and December 31, 2020	—	—
Common stock, 0.001 par value; 4,990,000,000 shares authorized at December 31, 2021 and December 31, 2020; 443,963,107 and 442,895,261 issued and outstanding at December 31, 2021 and December 31, 2020, respectively	4,024,561	3,447,698
Treasury stock at cost (1,564,478 shares at December 31, 2021)	(824,190)	—
Accumulated other comprehensive income (loss)	(40,495)	44,398
Retained earnings	12,689,372	7,573,144
Total stockholders' equity	15,849,248	11,065,240
Total liabilities and stockholders' equity	<u>\$ 44,584,663</u>	<u>\$ 39,280,359</u>

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,		
	2021	2020	2019
Revenues	\$ 29,697,844	\$ 24,996,056	\$ 20,156,447
Cost of revenues	17,332,683	15,276,319	12,440,213
Marketing	2,545,146	2,228,362	2,652,462
Technology and development	2,273,885	1,829,600	1,545,149
General and administrative	1,351,621	1,076,486	914,369
Operating income	6,194,509	4,585,289	2,604,254
Other income (expense):			
Interest expense	(765,620)	(767,499)	(626,023)
Interest and other income (expense)	411,214	(618,441)	84,000
Income before income taxes	5,840,103	3,199,349	2,062,231
Provision for income taxes	(723,875)	(437,954)	(195,315)
Net income	\$ 5,116,228	\$ 2,761,395	\$ 1,866,916
Earnings per share:			
Basic	\$ 11.55	\$ 6.26	\$ 4.26
Diluted	\$ 11.24	\$ 6.08	\$ 4.13
Weighted-average common shares outstanding:			
Basic	443,155	440,922	437,799
Diluted	455,372	454,208	451,765

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

# Amortization expense disclosure.

	Year ended December 31,		
	2021	2020	2019
	(in thousands)		
Licensed content	\$ 8,055,811	\$ 7,544,631	\$ 7,242,799
Produced content	4,174,556	3,262,281	1,973,448
Total	\$ 12,230,367	\$ 10,806,912	\$ 9,216,247

# Cash Flow Statement.

	Year Ended December 31,		
	2021	2020	2019
<b>Cash flows from operating activities:</b>			
Net income	\$ 5,116,228	\$ 2,761,395	\$ 1,866,916
<b>Adjustments to reconcile net income to net cash provided by (used in) operating activities:</b>			
Additions to content assets	(17,702,202)	(11,779,284)	(13,916,683)
Change in content liabilities	232,898	(757,433)	(694,011)
Amortization of content assets	12,230,367	10,806,912	9,216,247
Depreciation and amortization of property, equipment and intangibles	208,412	115,710	103,579
Stock-based compensation expense	403,220	415,180	405,376
Foreign currency remeasurement loss (gain) on debt	(430,661)	533,278	(45,576)
Other non-cash items	376,777	293,126	228,230
Deferred income taxes	199,548	70,066	(94,443)
<b>Changes in operating assets and liabilities:</b>			
Other current assets	(369,681)	(187,623)	(252,113)
Accounts payable	145,115	(41,605)	96,063
Accrued expenses and other liabilities	180,338	198,183	157,778
Deferred revenue	91,350	193,247	163,846
Other non-current assets and liabilities	(289,099)	(194,075)	(122,531)
Net cash provided by (used in) operating activities	392,610	2,427,077	(2,887,322)

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

# Streaming Content Obligations (cont'd).

	As of December 31,	
	2021	2020
	(in thousands)	
Less than one year	\$ 10,019,306	\$ 8,980,868
Due after one year and through 3 years	9,238,315	7,819,563
Due after 3 years and through 5 years	3,238,977	1,973,091
Due after 5 years	664,762	445,308
Total content obligations	<u>\$ 23,161,360</u>	<u>\$ 19,218,830</u>

# 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,		
	2021	2020	2019
Cash flows from operating activities:			
Net income	\$ 5,116,228	\$ 2,761,395	\$ 1,866,916
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Additions to content assets	(17,702,202)	(11,779,284)	(13,916,683)
Change in content liabilities	232,898	(757,433)	(694,011)
Amortization of content assets	12,230,367	10,806,912	9,216,247

~\$17.5 bil. in cash spent on streaming content in FY21 vs. \$12.2 bil. in content amortization, resulting in a 1.4x ratio of cash spend on content to content amort. 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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