Overview of Content Accounting

Investor Relations
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NETFLIX

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.

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)

Examples.

	Netflix Originals (Branded)		2nd Run movies & TV shows
Type of content	Self-produced	Licensed	Licensed
Examples	*Stranger Things, The OA, Dave Chappelle, Ingobernable, Ridiculous 6, Santa Clarita Diet, 3%, A Series of Unfortunate Events*	*House of Cards* (MRC), *Orange is the New Black* (Lionsgate), *Iron Fist* (Marvel), *Narcos* (Gaumont), *Bloodline* (Sony)	*Shameless* (Showtime), *How to Get Away with Murder* (ABC), *Friends* (Warner Bros.), *Captain America: Civil War* (Disney)

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.

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 are included in "Non-current content library, net" in our balance sheet.

Produced assets are included in non-current content library

	As of December 31, 2017	As of December 31, 2016
	(in thousands)	
Licensed content, net	$11,771,778	$ 9,595,315
Produced content, net		
Released, less amortization	1,427,256	335,400
In production	1,311,137	1,010,463
In development and pre-production	158,517	34,215
	2,896,910	1,380,078
DVD, net	13,301	25,415
Total	$14,681,989	$11,000,808
Current content assets, net	$ 4,310,934	$ 3,726,307
Non-current content assets, net	$10,371,055	$ 7,274,501

Financial statements.

Content accounting in our financials.

Balance sheet

- Total cost of titles is recorded as assets in the content library
- 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 library = total gross additions (not cash paid)
- Change in streaming content liabilities = net change in liabilities resulting from payments and library additions, both current and non-current
- Amortization of content library = adjusts for the non-cash expense included in net income

Balance Sheet.

	As of December 31, 2017	As of December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 2,822,795	$ 1,467,576
Short-term investments	—	266,206
Current content assets, net	4,310,934	3,726,307
Other current assets	536,245	260,202
Total current assets	7,669,974	5,720,291
Non-current content assets, net	10,371,055	7,274,501
Property and equipment, net	319,404	250,395
Other non-current assets	652,309	341,423
Total assets	$ 19,012,742	$ 13,586,610
Liabilities and Stockholders' Equity		
Current liabilities:		
Current content liabilities	$ 4,173,041	$ 3,632,711
Accounts payable	359,555	312,842
Accrued expenses	315,094	197,632
Deferred revenue	618,622	443,472
Total current liabilities	5,466,312	4,586,657
Non-current content liabilities	3,329,796	2,894,654
Long-term debt	6,499,432	3,364,311
Other non-current liabilities	135,246	61,188
Total liabilities	15,430,786	10,906,810
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized at December 31, 2017 and 2016; no shares issued and outstanding at December 31, 2017 and 2016	—	—
Common stock, $0.001 par value; 4,990,000,000 shares authorized at December 31, 2017 and December 31, 2016, respectively; 433,392,686 and 430,054,212 issued and outstanding at December 31, 2017 and December 31, 2016, respectively	1,871,396	1,599,762
Accumulated other comprehensive loss	(20,557)	(48,565)
Retained earnings	1,731,117	1,128,603
Total stockholders' equity	3,581,956	2,679,800
Total liabilities and stockholders' equity	$ 19,012,742	$ 13,586,610

Available licensed content assets expected to be amortized in next 12 mos.

Non-current content assets include produced assets and available licensed assets expected to be amortized beyond 12 mos.

Content payments due within 12 months

Content payments due > 1 year

Income Statement.

	Year ended December 31,		
	2017	2016	2015
Revenues	$ 11,692,713	$ 8,830,669	$ 6,779,511
Cost of revenues	7,659,666	6,029,901	4,591,476
Marketing	1,278,022	991,078	824,092
Technology and development	1,052,778	852,098	650,788
General and administrative	863,568	577,799	407,329
Operating income	838,679	379,793	305,826
Other income (expense):			
Interest expense	(238,204)	(150,114)	(132,716)
Interest and other income (expense)	(115,154)	30,828	(31,225)
Income before income taxes	485,321	260,507	141,885
Provision for (benefit from) income taxes	(73,608)	73,829	19,244
Net income	$ 558,929	$ 186,678	$ 122,641
Earnings per share:			
Basic	$ 1.29	$ 0.44	$ 0.29
Diluted	$ 1.25	$ 0.43	$ 0.28
Weighted-average common shares outstanding:			
Basic	431,885	428,822	425,889
Diluted	446,814	438,652	436,456

Content amortization included in cost of revenue and broken out in our segment disclosure

Cash Flow Statement.

	Year Ended December 31,		
	2017	2016	2015
Cash flows from operating activities:			
Net income	$ 558,929	$ 186,678	$ 122,641
Adjustments to reconcile net income to net cash used in operating activities:			
Additions to streaming content assets	(9,805,763)	(8,653,286)	(5,771,652)
Change in streaming content liabilities	900,006	1,772,650	1,162,413
Amortization of streaming content assets	6,197,817	4,788,498	3,405,382
Amortization of DVD content assets	60,657	78,952	79,380
Depreciation and amortization of property, equipment and intangibles	71,911	57,528	62,283
Stock-based compensation expense	182,209	173,675	124,725
Excess tax benefits from stock-based compensation	—	(65,121)	(80,471)
Other non-cash items	57,207	40,909	31,628
Foreign currency remeasurement loss on long-term debt	140,790	—	—
Deferred taxes	(208,688)	(46,847)	(58,655)
Changes in operating assets and liabilities:			
Other current assets	(234,090)	46,970	18,693
Accounts payable	74,559	32,247	51,615
Accrued expenses	114,337	68,706	48,810
Deferred revenue	177,974	96,751	72,135
Other non-current assets and liabilities	(73,803)	(52,294)	(18,366)
Net cash used in operating activities	(1,785,948)	(1,473,984)	(749,439)
Cash flows from investing activities:			
Acquisitions of DVD content assets	(53,720)	(77,177)	(77,958)
Purchases of property and equipment	(173,302)	(107,653)	(91,248)
Other assets	(6,689)	(941)	(1,912)
Purchases of short-term investments	(74,819)	(187,193)	(371,915)
Proceeds from sale of short-term investments	320,154	282,484	259,079
Proceeds from maturities of short-term investments	22,705	140,245	104,762
Net cash provided by (used in) investing activities	34,329	49,765	(179,192)

Includes content amortization from P&L

Gross additions to content library

Change in content liabilities (ST & LT)

Content amortization

Cash for DVD content

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. 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 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

	Payments due by Period				
Contractual obligations (in thousands):	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Streaming content obligations (1)	$ 17,694,642	$ 7,446,947	$ 8,210,159	$ 1,894,001	$ 143,535

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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 $3 billion to $5 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).

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,		
	2017	2016	2015
Cash flows from operating activities:			
Net income	$ 558,929	$ 186,678	$ 122,641
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~$8.9 bil. in cash spent on streaming content in 2017 vs. $6.2 bil. in content amortization, resulting in a 1.4x 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 projected viewing patterns)

FAQ (continued).

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

- We review our content library in aggregate at the operating segment level to evaluate if there are any changes in circumstances that signal a change in the expected useful life of the content
- 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, net realizable value or fair value if an impairment is identified

Thank you.

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