NETFLIX INC
Form 10-Q
May 09, 2006
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number: 000-49802

Netflix, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**77-0467272**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

100 Winchester Circle, Los Gatos, California 95032

(Address and zip code of principal executive offices)

(408) 540-3700

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act) Yes ¨ No x

As of May 4, 2006, there were 59,473,862 shares of the registrant s common stock, par value $0.001, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. **Financial Statements**

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Netflix, Inc.

Condensed Consolidated Statements of Operations

(unaudited)

(in thousands, except per share data)

	March 31, 2005	March 31, 2006
Revenues	$ 152,446	$ 224,126
Cost of revenues:		
Subscription	93,986	126,220
Fulfillment expenses*	17,135	22,045
Total cost of revenues	111,121	148,265
Gross profit	41,325	75,861
Operating expenses:		
Technology and development*	8,566	11,206
Marketing*	36,549	52,968
General and administrative*	6,688	8,292
Gain on disposal of DVDs	(695)	(1,387)
Total operating expenses	51,108	71,079
Operating income (loss)	(9,783)	4,782
Other income (expense):		
Interest and other income	1,051	2,452
Interest and other expense	(38)	
Income (loss) before income taxes	(8,770)	7,234
Provision for income taxes	44	2,830
Net income (loss)	$ (8,814)	$ 4,404
Net income (loss) per share:		
Basic	$ (.17)	$ .08
Diluted	$ (.17)	$ .07
Weighted average common shares outstanding:		
Basic	52,816	55,213
Diluted	52,816	66,456
*Amortization of stock-based compensation included in expense line items:		
Fulfillment	$ 441	$ 260

Technology and development	1,411	965
Marketing	746	554
General and administrative	1,681	1,531
	$ 4,279	$ 3,310

See accompanying notes to condensed consolidated financial statements.

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Netflix, Inc.

Condensed Consolidated Balance Sheets

(unaudited)

(in thousands, except share and par value data)

	As of	
	December 31, 2005	**March 31, 2006**
Assets		
Current assets:		
Cash and cash equivalents	$ 212,256	$ 227,765
Prepaid expenses	7,848	4,233
Prepaid revenue sharing expenses	5,252	5,796
Deferred tax assets	13,666	12,090
Other current assets	4,669	5,436
Total current assets	243,691	255,320
DVD library, net	57,032	73,995
Intangible assets, net	457	445
Property and equipment, net	40,213	40,088
Deposits	1,249	1,290
Deferred tax assets	21,239	20,757
Other assets	800	1,050
Total assets	$ 364,681	$ 392,945
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 63,491	$ 77,996
Accrued expenses	25,563	28,312
Deferred revenue	48,533	47,925
Total current liabilities	137,587	154,233
Deferred rent	842	912
Total liabilities	138,429	155,145
Stockholders equity:		
Common stock, $0.001 par value; 160,000,000 shares authorized at December 31, 2005 and March 31, 2006; 54,755,731 and 55,510,338 issued and outstanding at December 31, 2005 and March 31, 2006, respectively	55	55
Additional paid-in capital	315,868	323,012
Accumulated deficit	(89,671)	(85,267)
Total stockholders equity	226,252	237,800
Total liabilities and stockholders equity	$ 364,681	$ 392,945

See accompanying notes to condensed consolidated financial statements.

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Netflix, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Three Months Ended	
	March 31, 2005	**March 31, 2006**
Cash flows from operating activities:		
Net income (loss)	$ (8,814)	$ 4,404
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property and equipment	1,938	3,609
Amortization of DVD library	22,006	27,281
Amortization of intangible assets	454	12
Stock-based compensation expense	4,279	3,310
Excess tax benefits from stock-based compensation		(690)
Loss on disposal of property and equipment		(23)
Gain on disposal of DVDs	(1,129)	(2,049)
Noncash interest expense	11	
Deferred taxes		2,058
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	4,671	2,304
Accounts payable	2,857	14,505
Accrued expenses	2,550	3,439
Deferred revenue	527	(608)
Deferred rent	93	70
Net cash provided by operating activities	29,443	57,622
Cash flows from investing activities:		
Purchases of property and equipment	(6,845)	(3,484)
Acquisitions of DVD library	(33,040)	(44,676)
Proceeds from sale of DVDs	1,694	2,481
Proceeds from disposal of property and equipment		23
Deposits and other assets	(177)	(291)
Net cash used in investing activities	(38,368)	(45,947)
Cash flows from financing activities:		
Proceeds from issuance of common stock	365	3,144
Principal payments on notes payable and capital lease obligations	(79)	
Excess tax benefits from stock-based compensation		690
Net cash provided by financing activities	286	3,834

Net increase (decrease) in cash and cash equivalents	(8,639)	15,509
Cash and cash equivalents, beginning of period	174,461	212,256
Cash and cash equivalents, end of period	$ 165,822	$ 227,765

See accompanying notes to condensed consolidated financial statements.

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Netflix, Inc.

Notes to Condensed Consolidated Financial Statements

(in thousands, except shares, per share data and percentages)

1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed consolidated interim financial statements of Netflix, Inc. and its wholly owned subsidiary (the Company) have been prepared in conformity with accounting principles generally accepted in the United States and are consistent in all material respects with those applied in the Company s annual report on Form 10-K for the year ended December 31, 2005. The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Examples include the estimate of useful lives and residual value of its DVD library; the valuation of stock-based compensation; and the recognition and measurement of income tax assets and liabilities. The actual results experienced by the Company may differ from management s estimates.

The interim financial information is unaudited, but reflects all normal recurring adjustments that are, in the opinion of management, necessary to fairly present the information set forth therein. The interim financial statements should be read in conjunction with the audited financial statements and related notes included in the Company s 2005 annual report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2006. Interim results are not necessarily indicative of the results for a full year.

Reclassifications

Certain amounts in the Company s prior years Condensed Consolidated Statements of Operations were reclassified to conform with the current period presentation. Proceeds from sales of previously viewed DVDs and the related cost of DVDs sold were reported as Sales revenues and Cost of sales revenues, respectively, in the Condensed Consolidated Statements of Operations in previous years. In light of discussions with the SEC and consistent with the guidance in Statement of Financial Accounting Standards (SFAS) 95, *Statement of Cash Flows,* and SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* , in the fourth quarter of 2005 the Company began to report the net gain on sales of DVDs as a separate line item within Operating expenses. Accordingly, Sales revenues and Cost of sales revenues contained in the Condensed Consolidated Statements of Operations for the three months ended March 31, 2005 have been reclassified to conform to the current presentation. Cash flows associated with the acquisition of its DVD Library and proceeds from sale of DVDs continue to be classified as cash flows from investing activities in the Condensed Consolidated Statements of Cash Flows.

Additionally, in light of discussions with the SEC, the Company reclassified fulfillment expenses in its Condensed Consolidated Statements of Operations as a component of Cost of revenues in the fourth quarter of 2005. In prior periods the Company had reported Fulfillment expenses as a component of Operating expenses. Accordingly, Cost of revenues, Gross profit and Operating expenses in the Condensed Consolidated Statements of Operations for the three month ended March 31, 2005 have been reclassified to conform to the current presentation.

In accordance with the SEC Staff Accounting Bulletin No. 107 (SAB 107), stock-based compensation is no longer presented as a separate line item on our Condensed Consolidated Statements of Operations. Stock-based compensation is now presented in the same lines as cash compensation paid to the same individuals. Stock-based compensation recognized in prior periods has been reclassified to conform with the presentation in the current period.

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Netflix, Inc.

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands, except shares, per share data and percentages)

The reclassifications did not impact operating income (loss) or net income (loss), working capital or net cash provided by operating activities as previously reported. The following amounts were reclassified for the three months ended March 31, 2005:

	Three Months Ended March 31, 2005		
Condensed Consolidated Statements of Operations	**As previously reported**	**Reclassifications**	**As Reclassified**
Revenues:			
Subscription	$ 152,446	$	$ 152,446
Sales	1,694	(1,694)	
Total revenues	154,140	(1,694)	152,446
Cost of revenues:			

Further, the iShares® iBoxx $ High Yield Corporate Bond ETF is designed to provide a representation of the U.S. dollar high-yield corporate market and is therefore subject to high-yield securities risk. Securities that are rated below investment grade (commonly known as “junk bonds”) may be more volatile than higher-rated securities of similar maturity. High-yield securities may also be subject to greater levels of credit or default risk than higher-rated securities. The value of high-yield securities can be adversely affected by overall economic conditions, such as an economic downturn or a period of rising interest rates, and high-yield securities may be less liquid and more difficult to sell at an advantageous time or price or to value than higher-rated securities. In particular, high-yield securities are often issued by smaller, less creditworthy companies or by highly leveraged (indebted) firms, which are generally less able than more financially stable firms to make scheduled payments of interest and principal.

- The Notes Are Subject to Significant Risks Associated with Fixed-Income Securities, Including Interest Rate-Related Risks — The Bond ETFs are bond ETFs that attempt to track the performance of indices composed of fixed income securities. Investing in the Notes linked indirectly to these ETFs differs significantly from investing directly in bonds to be held to maturity as the values of the Bond ETFs change, at times significantly, during each trading day based upon the current market prices of their underlying bonds. The market prices of these bonds are volatile and significantly influenced by a number of factors, particularly the yields on these bonds as compared to current market interest rates and the actual or perceived credit quality of the issuer of these bonds. The market prices of the bonds underlying each of the Bond ETFs are determined by reference to the bid and ask quotations provided by 10 contributing banks, one of which is our affiliate.

In general, fixed-income securities are significantly affected by changes in current market interest rates. As interest rates rise, the price of fixed-income securities, including those underlying the Bond ETFs, is likely to decrease. Securities with longer durations tend to be more sensitive to interest rate changes, usually making them more volatile than securities with shorter durations. The eligibility criteria for the securities included in the indices that underlie the Bond ETFs, which each mandate that each security must have a minimum term remaining to maturity (ranging from one year to 20 years) for continued eligibility, means that, at any time, only longer-term securities underlie the Bond

ETFs, which thereby increases the risk of price volatility in the underlying securities and, consequently, the volatility in the value of these indices. As a result, rising interest rates may cause the value of the bonds underlying the Bond ETFs, the Bond ETFs and these indices to decline, possibly significantly.

Interest rates are subject to volatility due to a variety of factors, including:

- sentiment regarding underlying strength in the U.S. and global economies;
- expectations regarding the level of price inflation;
- sentiment regarding credit quality in the U.S. and global credit markets;
- central bank policies regarding interest rates; and
- the performance of U.S. and foreign capital markets.

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INFORMATION REGARDING THE BASKET COMPONENTS

We have derived the following information from publicly available documents. We are not affiliated with any of the Basket Components and each Basket Component will have no obligations with respect to the Notes. This terms supplement relates only to the Notes and does not relate to any of the shares of any Basket Component or to the securities or other assets held by any Basket Component. Neither we nor RBC Capital Markets, LLC participates in the preparation of the publicly available documents described below. Neither we nor RBC Capital Markets, LLC has made any due diligence inquiry with respect to any Basket Component in connection with the offering of the Notes. There can be no assurance that all events occurring prior to the date of this terms supplement, including events that would affect the accuracy or completeness of the publicly available documents described below, that would affect the trading price of the shares of any Basket Component have been or will be publicly disclosed. Subsequent disclosure of any events or the disclosure of or failure to disclose material future events concerning any Basket Component could affect the value of the shares of that Basket Component on the Valuation Date and therefore could affect the Payment at Maturity.

Each Basket Component is registered under the Securities Exchange Act of 1934 (the “Exchange Act”). Companies with securities registered under that Act are required to file periodically certain financial and other information specified by the Securities and Exchange Commission (the “SEC”). Information provided to or filed with the SEC can be obtained through the SEC’s website at www.sec.gov. However, none of the information on that website shall be deemed to be included or incorporated by reference in this document.

The SPDR® S&P 500® ETF Trust

The shares of the SPDR® S&P 500® ETF trade on the NYSE Arca under the symbol “SPY.” The SPY’s investment adviser is BlackRock Fund Advisors.

The SPY seeks to provide investment results that correspond generally to the price and yield performance, before fees and expenses, of the S&P 500® Index (the “SPX Index”). To maintain the correspondence between the composition and weightings of stocks held by the SPY and component stocks of the SPX Index, the SPY adjusts its holdings from time to time to conform to periodic changes in the identity and/or relative weightings of the index securities.

The SPY utilizes a “passive” or “indexing” investment approach in attempting to track the performance of the SPX Index. The SPY seeks to invest in substantially all of the securities that comprise the SPX Index. The SPY typically earns income from dividends from securities that it holds. These amounts, net of expenses and taxes (if applicable), are passed along to the SPY’s shareholders as “ordinary income.” In addition, the SPY realizes capital gains or losses whenever it sells securities. Net long-term capital gains are distributed to shareholders as “capital gain distributions.”

The S&P 500® Index (the “SPX Index”)

The SPX Index is intended to provide an indication of the pattern of common stock price movement. The calculation of the level of the SPX Index is based on the relative value of the aggregate market value of the common stocks of 500 companies as of a particular time compared to the aggregate average market value of the common stocks of 500 similar companies during the base period of the years 1941 through 1943.

S&P calculates the SPX Index by reference to the prices of the constituent stocks of the SPX Index without taking account of the value of dividends paid on those stocks. As a result, the return on the Notes will not reflect the return you would realize if you actually owned the SPX Index constituent stocks and received the dividends paid on those stocks.

Effective with the September 2015 rebalance, consolidated share class lines will no longer be included in the SPX Index. Each share class line will be subject to public float and liquidity criteria individually, but the company’s total market capitalization will be used to evaluate each share class line. This may result in one listed share class line of a company being included in the SPX Index while a second listed share class line of the same company is excluded.

Computation of the SPX Index

While S&P currently employs the following methodology to calculate the SPX Index, no assurance can be given that S&P will not modify or change this methodology in a manner that may affect the Payment at Maturity.

Historically, the market value of any component stock of the SPX Index was calculated as the product of the market price per share and the number of then outstanding shares of such component stock. In March 2005, S&P began shifting the SPX Index halfway from a market capitalization weighted formula to a float-adjusted formula, before moving the SPX Index to full float adjustment on September 16, 2005. S&P’s criteria for selecting stocks for the SPX Index did not change with the shift to float adjustment. However, the adjustment affects each company’s weight in the SPX Index.

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Under float adjustment, the share counts used in calculating the SPX Index reflect only those shares that are available to investors, not all of a company's outstanding shares. Float adjustment excludes shares that are closely held by control groups, other publicly traded companies or government agencies.

In September 2012, all shareholdings representing more than 5% of a stock's outstanding shares, other than holdings by "block owners," were removed from the float for purposes of calculating the SPX Index. Generally, these "control holders" will include officers and directors, private equity, venture capital and special equity firms, other publicly traded companies that hold shares for control, strategic partners, holders of restricted shares, ESOPs, employee and family trusts, foundations associated with the company, holders of unlisted share classes of stock, government entities at all levels (other than government retirement/pension funds) and any individual person who controls a 5% or greater stake in a company as reported in regulatory filings. However, holdings by block owners, such as depositary banks, pension funds, mutual funds and ETF providers, 401(k) plans of the company, government retirement/pension funds, investment funds of insurance companies, asset managers and investment funds, independent foundations and savings and investment plans, will ordinarily be considered part of the float.

Treasury stock, stock options equity participation units, warrants, preferred stock, convertible stock, and rights are not part of the float. Shares held in a trust to allow investors in countries outside the country of domicile, such as depositary shares and Canadian exchangeable shares are normally part of the float unless those shares form a control block.

For each stock, an investable weight factor ("IWF") is calculated by dividing the available float shares by the total shares outstanding. Available float shares are defined as the total shares outstanding less shares held by control holders. This calculation is subject to a 5% minimum threshold for control blocks. For example, if a company's officers and directors hold 3% of the company's shares, and no other control group holds 5% of the company's shares, S&P would assign that company an IWF of 1.00, as no control group meets the 5% threshold. However, if a company's officers and directors hold 3% of the company's shares and another control group holds 20% of the company's shares, S&P would assign an IWF of 0.77, reflecting the fact that 23% of the company's outstanding shares are considered to be held for control. As of July 31, 2017, companies with multiple share class lines are no longer eligible for inclusion in the Reference Index. Constituents of the Reference Index prior to July 31, 2017 with multiple share class lines will be grandfathered in and continue to be included in the Reference Index. If a constituent company of the Reference Index reorganizes into a multiple share class line structure, that company will remain in the Reference Index at the discretion of the S&P Index Committee in order to minimize turnover.

The SPX Index is calculated using a base-weighted aggregate methodology. The level of the SPX Index reflects the total market value of all 500 component stocks relative to the base period of the years 1941 through 1943. An indexed number is used to represent the results of this calculation in order to make the level easier to use and track over time. The actual total market value of the component stocks during the base period of the years 1941 through 1943 has been set to an indexed level of 10. This is often indicated by the notation 1941-43 = 10. In practice, the daily calculation of the SPX Index is computed by dividing the total market value of the component stocks by the "index divisor." By itself, the index divisor is an arbitrary number. However, in the context of the calculation of the SPX Index, it serves as a link to the original base period level of the SPX Index. The index divisor keeps the SPX Index comparable over time and is the manipulation point for all adjustments to the SPX Index, which is index maintenance.

Index Maintenance

Index maintenance includes monitoring and completing the adjustments for company additions and deletions, share changes, stock splits, stock dividends, and stock price adjustments due to company restructuring or spinoffs. Some corporate actions, such as stock splits and stock dividends, require changes in the common shares outstanding and the stock prices of the companies in the SPX Index, and do not require index divisor adjustments.

To prevent the level of the SPX Index from changing due to corporate actions, corporate actions which affect the total market value of the SPX Index require an index divisor adjustment. By adjusting the index divisor for the change in market value, the level of the SPX Index remains constant and does not reflect the corporate actions of individual companies in the SPX Index. Index divisor adjustments are made after the close of trading and after the calculation of the SPX Index closing level.

Changes in a company's total shares outstanding of 5% or more due to public offerings are made as soon as reasonably possible. Other changes of 5% or more (for example, due to tender offers, Dutch auctions, voluntary exchange offers, company stock repurchases, private placements, acquisitions of private companies or non-index companies that do not trade on a major exchange, redemptions, exercise of options, warrants, conversion of preferred stock, notes, debt, equity participations, at-the-market stock offerings or other recapitalizations) are made weekly, and are generally announced on Fridays for implementation after the close of

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trading the following Friday (one week later). If a 5% or more share change causes a company's IWF to change by five percentage points or more, the IWF is updated at the same time as the share change. IWF changes resulting from partial tender offers are considered on a case-by-case basis.

iShares® MSCI EAFE ETF

The shares of the iShares® MSCI EAFE ETF trade on the NYSE Arca under the symbol "EFA."

The EFA seeks to track the investment results of large- and mid-capitalization developed market equities, excluding the U.S. and Canada, as measured by the MSCI EAFE® Index (the "EAFE Index").

The EFA is maintained and managed by iShares and advised by BlackRock Fund Advisors. iShares is a registered investment company that consists of numerous separate investment portfolios, including the EFA. The EFA typically earns income from dividends from securities included in the EAFE Index. These amounts, net of expenses and taxes (if applicable), are passed along to the EFA's shareholders as "ordinary income." In addition, the EFA realizes capital gains or losses whenever it sells securities. Net long-term capital gains are distributed to shareholders as "capital gain distributions."

The MSCI EAFE Index (the "EAFE Index")

The EAFE Index is a stock index calculated, published and disseminated daily by MSCI Inc. ("MSCI"), through numerous data vendors, on the MSCI website and in real time on Bloomberg Financial Markets and Reuters Limited. MSCI has no any obligation to continue to calculate and publish, and may discontinue calculation and publication of the EAFE Index.

The EAFE Index is a free float-adjusted market capitalization index with a base date of December 31, 1969 and an initial value of 100. The EAFE Index is calculated daily in U.S. dollars and published in real time every 60 seconds during market trading hours. The EAFE Index currently consists of the following 21 developed countries: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, The Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The EAFE Index is comprised of companies in both the Large Cap Index and Mid Cap Index, as discussed in the section "—Defining Market Capitalization Size Segments for Each Market" below. The EAFE Index is part of the MSCI Regional Equity Indices series and is an MSCI Global Investable Market Index, which is a family within the MSCI International Equity Indices.

General - MSCI Indices

MSCI provides global equity indices intended to measure equity performance in international markets and the MSCI International Equity Indices are designed to serve as global equity performance benchmarks. In constructing these indices, MSCI applies its index construction and maintenance methodology across developed, emerging, and frontier markets.

MSCI enhanced the methodology used in its MSCI International Equity Indices. The MSCI Standard and MSCI Small Cap Indices, along with the other MSCI equity indices based on them, transitioned to the global investable market indices methodology described below. The transition was completed at the end of May 2008. The Enhanced MSCI Standard Indices are composed of the MSCI Large Cap and Mid Cap Indices. The MSCI Global Small Cap Index transitioned to the MSCI Small Cap Index resulting from the Global Investable Market Indices methodology and contains no overlap with constituents of the transitioned MSCI Standard Indices. Together, the relevant MSCI Large Cap, Mid Cap, and Small Cap Indices will make up the MSCI investable market index for each country, composite, sector, and style index that MSCI offers.

Constructing the MSCI Global Investable Market Indices. MSCI undertakes an index construction process, which involves:

· defining the equity universe;

- determining the market investable equity universe for each market;
- determining market capitalization size segments for each market;
- applying index continuity rules for the MSCI Standard Index;
- creating style segments within each size segment within each market; and
- classifying securities under the Global Industry Classification Standard (the "GICS").

Defining the Equity Universe. The equity universe is defined by:

- Identifying Eligible Equity Securities: the equity universe initially looks at securities listed in any of the countries in the MSCI Global Index Series, which will be classified as either Developed Markets ("DM") or Emerging Markets ("EM"). All listed equity securities, including Real Estate Investment Trusts, are eligible for inclusion in the equity universe. Conversely, mutual funds, ETFs, equity derivatives and most investment trusts are not eligible for inclusion in the equity universe.

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- Classifying Eligible Securities into the Appropriate Country: each company and its securities (i.e., share classes) are classified in only one country.

Effective with the November 2015 semi-annual index review, companies traded outside of their country of classification (i.e., “foreign listed companies”) became eligible for inclusion in the MSCI Country Investable Market Indexes along with the applicable MSCI Global Index. In order for a MSCI Country Investable Market Index to be eligible to include foreign listed companies, it must meet the Foreign Listing Materiality Requirement. To meet the Foreign Listing Materiality Requirement, the aggregate market capitalization of all securities represented by foreign listings should represent at least (i) 5% of the free float-adjusted market capitalization of the relevant MSCI Country Investable Market Index and (ii) 0.05% of the free-float adjusted market capitalization of the MSCI ACWI Investable Market Index.

Determining the Market Investable Equity Universes. A market investable equity universe for a market is derived by applying investability screens to individual companies and securities in the equity universe that are classified in that market. A market is equivalent to a single country, except in DM Europe, where all DM countries in Europe are aggregated into a single market for index construction purposes. Subsequently, individual DM Europe country indices within the MSCI Europe Index are derived from the constituents of the MSCI Europe Index under the global investable market indices methodology.

The investability screens used to determine the investable equity universe in each market are as follows:

- Equity Universe Minimum Size Requirement: this investability screen is applied at the company level. In order to be included in a market investable equity universe, a company must have the required minimum full market capitalization.
- Equity Universe Minimum Free Float–Adjusted Market Capitalization Requirement: this investability screen is applied at the individual security level. To be eligible for inclusion in a market investable equity universe, a security must have a free float–adjusted market capitalization equal to or higher than 50% of the equity universe minimum size requirement.
- DM and EM Minimum Liquidity Requirement: this investability screen is applied at the individual security level. To be eligible for inclusion in a market investable equity universe, a security must have adequate liquidity. The twelve-month and three-month Annual Traded Value Ratio (“ATVR”), a measure that screens out extreme daily trading volumes and takes into account the free float–adjusted market capitalization size of securities, together with the three-month frequency of trading are used to measure liquidity. A minimum liquidity level of 20% of three- and twelve-month ATVR and 90% of three-month frequency of trading over the last four consecutive quarters are required for inclusion of a security in a market investable equity universe of a DM, and a minimum liquidity level of 15% of three- and twelve-month ATVR and 80% of three-month frequency of trading over the last four consecutive quarters are required for inclusion of a security in a market investable equity universe of an EM.
- Global Minimum Foreign Inclusion Factor Requirement: this investability screen is applied at the individual security level. To be eligible for inclusion in a market investable equity universe, a security’s Foreign Inclusion Factor (“FIF”) must reach a certain threshold. The FIF of a security is defined as the proportion of shares outstanding that is available for purchase in the public equity markets by international investors. This proportion accounts for the available free float of and/or the foreign ownership limits applicable to a specific security (or company). In general, a security must have an FIF equal to or larger than 0.15 to be eligible for inclusion in a market investable equity universe.
- Minimum Length of Trading Requirement: this investability screen is applied at the individual security level. For an initial public offering (“IPO”) to be eligible for inclusion in a market investable equity universe, the new issue must have started trading at least three months before the implementation of a semi–annual index review (as described

below). This requirement is applicable to small new issues in all markets. Large IPOs are not subject to the minimum length of trading requirement and may be included in a market investable equity universe and the Standard Index outside of a Quarterly or Semi−Annual Index Review.

- Minimum Foreign Room Requirement: this investability screen is applied at the individual security level. For a security that is subject to a foreign ownership limit to be eligible for inclusion in a market investable equity universe, the proportion of shares still available to foreign investors relative to the maximum allowed (referred to as "foreign room") must be at least 15%.

Defining Market Capitalization Size Segments for Each Market. Once a market investable equity universe is defined, it is segmented into the following size−based indices:

- Investable Market Index (Large + Mid + Small);
- Standard Index (Large + Mid);
- Large Cap Index;
- Mid Cap Index; or

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· Small Cap Index.

Creating the size segment indices in each market involves the following steps:

· defining the market coverage target range for each size segment;
· determining the global minimum size range for each size segment;
· determining the market size segment cutoffs and associated segment number of companies;
· assigning companies to the size segments; and
· applying final size−segment investability requirements.

Index Continuity Rules for the Standard Indices. In order to achieve index continuity, as well as to provide some basic level of diversification within a market index, and notwithstanding the effect of other index construction rules described in this section, a minimum number of five constituents will be maintained for a DM Standard Index and a minimum number of three constituents will be maintained for an EM Standard Index.

Creating Style Indices within Each Size Segment. All securities in the investable equity universe are classified into value or growth segments using the MSCI Global Value and Growth methodology.

Classifying Securities under the Global Industry Classification Standard. All securities in the global investable equity universe are assigned to the industry that best describes their business activities. To this end, MSCI has designed, in conjunction with S&P Dow Jones Indexes, the GICS. Under the GICS, each company is assigned to one sub−industry according to its principal business activity. Therefore, a company can belong to only one industry grouping at each of the four levels of the GICS.

Index Maintenance

The MSCI Global Investable Market Indices are maintained with the objective of reflecting the evolution of the underlying equity markets and segments on a timely basis, while seeking to achieve index continuity, continuous investability of constituents and replicability of the indices, index stability and low index turnover. In particular, index maintenance involves:

(i) Semi−Annual Index Reviews ("SAIRs") in May and November of the Size Segment and Global Value and Growth Indices which include:

· updating the indices on the basis of a fully refreshed equity universe;
· taking buffer rules into consideration for migration of securities across size and style segments; and
· updating FIFs and Number of Shares ("NOS").

(ii) Quarterly Index Reviews in February and August of the Size Segment Indices aimed at:

· including significant new eligible securities (such as IPOs that were not eligible for earlier inclusion) in the index;
· allowing for significant moves of companies within the Size Segment Indices, using wider buffers than in the SAIR; and
· reflecting the impact of significant market events on FIFs and updating NOS.

(iii) Ongoing Event−Related Changes: changes of this type are generally implemented in the indices as they occur. Significantly large IPOs are included in the indices after the close of the company's tenth day of trading.

None of us, RBCCM or any of our other affiliates accepts any responsibility for the calculation, maintenance, or publication of, or for any error, omission, or disruption in, the index or any successor to the index.

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The SPDR® Gold Trust

The SPDR® Gold Trust, or the Gold Trust, issues SPDR® Gold Shares, or the "Shares," which represent units of fractional undivided beneficial interest in and ownership of the Gold Trust. World Gold Trust Services, LLC is the sponsor of the Gold Trust, or the Sponsor. BNY Mellon Asset Servicing, a division of The Bank of New York Mellon, is the trustee of the Gold Trust, or the Trustee, HSBC Bank plc is the custodian of the Gold Trust, or the Custodian, and State Street Global Advisors Fund Distributors, LLC is the marketing agent of the Gold Trust, or the Marketing Agent. The Gold Trust intends to issue additional Shares on a continuous basis through its Trustee. The Gold Trust is not a commodity pool for purposes of the Commodity Exchange Act of 1936, as amended, and its sponsor is not subject to regulation by the Commodity Futures Trading Commission as a commodity pool operator, or a commodity trading advisor.

The Shares trade on NYSE Arca, Inc., or NYSE Arca, under the symbol "GLD."

The Shares may be purchased from the Gold Trust only in one or more blocks of 100,000 Shares (a block of 100,000 Shares is called a Basket). The Gold Trust issues Shares in Baskets to certain authorized participants, or the Authorized Participants, on an ongoing basis. Baskets are offered continuously at the net asset value, or the NAV, for 100,000 Shares on the day that an order to create a Basket is accepted by the Trustee.

The investment objective of the Gold Trust is to reflect the performance of the price of gold bullion, less the Gold Trust's expenses. The Gold Trust holds gold bars. The Gold Trust issues shares in exchange for deposits of gold and distributes gold in connection with the redemption of shares. The Shares of the Gold Trust are intended to offer investors an opportunity to participate in the gold market through an investment in securities. The ownership of the Shares of the Gold Trust is intended to overcome certain barriers to entry in the gold market, such as the logistics of buying, storing and insuring gold.

The Shares of the Gold Trust represent units of fractional undivided beneficial interest in and ownership of the Gold Trust, the primary asset of which is allocated (or secured) gold. The Gold Trust is not managed like a corporation or an active investment vehicle. The gold held by the Gold Trust will be sold only: (1) on an as-needed basis to pay the Gold Trust's expenses, (2) in the event the Gold Trust terminates and liquidates its assets or (3) as otherwise required by law or regulation.

Creation and Redemption

The SPDR® Gold Trust creates and redeems the Shares from time to time, but only in one or more baskets (a "basket" equals a block of 100,000 shares). The creation and redemption of baskets requires the delivery to the Gold Trust or the distribution by the Gold Trust of the amount of gold and any cash represented by the baskets being created or redeemed, the amount of which is based on the combined net asset value of the number of Shares included in the baskets being created or redeemed. The initial amount of gold required for deposit with the Gold Trust to create shares for the period from the formation of the Gold Trust to the first day of trading of the Shares on the NYSE was 10,000 ounces per basket. The number of ounces of gold required to create a basket or to be delivered upon the redemption of a basket gradually decreases over time, due to the accrual of the Gold Trust's expenses and the sale of the Gold Trust's gold to pay the Gold Trust's expenses. Baskets may be created or redeemed only by authorized participants, who pay a transaction fee for each order to create or redeem baskets and may sell the Shares included in the baskets they create to other investors.

Valuation of Gold; Computation of Net Asset Value

The Trustee determines the NAV of the Gold Trust on each day that NYSE Arca is open for regular trading at the earlier of (i) the afternoon session of the twice daily determination of the price of an ounce of gold through an auction by the London Bullion Market Association, or LBMA, administered by the ICE Benchmark Administration, or the IBA, which starts at 3:00 PM London, England time, or the LBMA Gold Price PM, or (ii) 12:00 PM New York time.

The LBMA Gold Price PM is determined by participants in a physically settled, electronic and tradable auction. The LBMA Gold Price PM replaced the previously established London PM Gold Fix on March 20, 2015. The NAV of the Gold Trust is the aggregate value of the Gold Trust's assets less its estimated accrued but unpaid liabilities (which include accrued expenses). In determining the Gold Trust's NAV, the Trustee values the gold held by the Gold Trust based on the LBMA Gold Price PM for an ounce of gold. The Trustee also determines the NAV per Share.

The Custodian is HSBC Bank plc and is responsible for the safekeeping of the Gold Trust's gold bars transferred to it in connection with the creation of Baskets by Authorized Participants. The Custodian also facilitates the transfer of gold in and out of the Gold Trust through gold accounts it maintains for Authorized Participants and the Gold Trust. The Custodian is a market maker, clearer and approved weigher under the rules of the LBMA.

P-15 RBC Capital Markets, LLC

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iShares iBoxx $ High Yield Corporate Bond ETF

The iShares iBoxx $ High Yield Corporate Bond ETF trades on the NYSE Arca, Inc. under the ticker symbol "HYG." The HYG seeks to track the investment results of the Markit iBoxx® USD Liquid High Yield Index (the "HY Index"). The underlying index is a rules-based index consisting of liquid U.S. dollar-denominated, high yield corporate bonds for sale in the United States, which is designed to provide a broad representation of the U.S. dollar-denominated high yield liquid corporate bond market.

The HYG generally invests at least 90% of its assets in securities that comprise the underlying index and in investments that provide substantially similar exposure to the securities in the underlying index. The HYG is passively managed and employs a Representative Sampling Strategy. The ETF's investment adviser is BlackRock Fund Advisors, and the underlying index is sponsored by Markit Indices Limited ("Markit"). More information regarding the HYG can be located on the iShares website; however, information on that website is not included or incorporated by reference into this document. The HYG is issued by the iShares Trust, a registered investment company.

The iBoxx® $ Liquid High Yield Index (the "HY Index")

The HY index is published by Markit. Markit has no obligation to continue to publish, and may discontinue publication of, the HY Index at any time.

The HY Index is designed to reflect the performance of the U.S. dollar-denominated high yield corporate debt. The HY Index is market-value weighted with an issuer cap of 3%.

The HY Index consists of sub-investment grade U.S. dollar-denominated bonds issued by corporate issuers from developed countries and rated by at least one of three rating services: Fitch Ratings ("Fitch"), Moody's Investors Service ("Moody's") or Standard & Poor's Rating Services ("S&P"). The HY Index composition is rebalanced once a month, after the close of business on the last business day of the rebalancing month (the "rebalancing date"). The new HY Index composition becomes effective on the first business day of the next month (the "composition month").

The bonds in the HY Index must meet all the criteria described below as of the close of business three business days prior to the rebalancing date, provided that the relevant bond data can be verified, at Markit's sole discretion, as of such date (the "bond selection cut-off date").

The HY Index is based on multi-sourced pricing which, depending on the structure of each market, takes into account a variety of data inputs such as transaction data, quotes from market makers and other observable data points. Prices for the bonds in the HY Index are sourced from a number of leading market makers. The received quotes are subject to a quality control process which is intended to exclude stale or off-market prices, and the quotes that pass the quality control are consolidated to the HY Index price. Additionally, the HY Index rules and their application are governed by two committees:

- Technical Committee: composed of representatives of market makers and banks. The Technical Committee meets once a month in order to provide feedback and information as to the monthly rebalancing, and to monitor market developments. It also provides assistance in the identification of eligible constituents, especially in the instance where the eligibility or the classification of a bond is unclear or contentious. Additionally, the Technical Committee discusses any market developments which may warrant index rule changes and provides recommendations on changes to the rules.
- Oversight Committee: composed of representatives from a broad range of asset managers, consultants and industry bodies. The purpose of the Oversight Committee is to review the recommendations of the Technical Committee and also to provide consultation on any market developments which may warrant rule changes.

Selection Criteria for the iBoxx $ Liquid High Yield Index

The following selection criteria are applied to select the constituents for the HY Index:

-

Bond Type. Only fixed-rate bonds whose cash flow can be determined in advance are eligible for the HY Index. The HY Index is comprised solely of bonds. Treasury Bills and other money market instruments are not eligible. The HY Index includes only U.S. dollar denominated bonds. In particular, bonds with the following characteristics are included: fixed coupon bonds, step-up bonds with coupon schedules known at issuance (or as functions of the issuer's rating), sinking funds and amortizing bonds, medium-term notes, Rule 144A offerings, callable bonds and putable bonds. The following instrument types are specifically excluded from the HY Index: preferred shares, optionally and mandatorily convertible bonds, subordinated bank or insurance debt with mandatory contingent conversion features or with any conversion options before the first call date, bonds with other equity features attached (e.g., options or warrants), private placements, perpetual bonds (unless callable and meets the time to maturity requirements set forth below), floating rate notes, pay-in-kind bonds (during the pay-in-kind period), zero coupon bonds, zero step-ups (GAINS), bonds with differences between accrual and coupon payment periods and monthly-paying bonds, and Regulation S offerings.

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Any bond subject to a firm call or tender offer, with the exception of exchange offers, in the month immediately following the rebalancing date will be excluded from the HY Index, provided that Markit is aware of that tender offer or call as of the bond selection cut-off date.

- Credit Rating. Bonds in the HY Index must have a Markit iBoxx Rating of sub-investment grade, which is defined as BB+ or lower by S&P or Fitch or Ba1 or lower by Moody's, but the bonds must not be in default. If a bond is rated by more than one of the foregoing ratings agencies, then the Markit iBoxx Rating is the average of the provided ratings. The rating is consolidated to the nearest rating grade in accordance with the Markit iBoxx Rules. Rating notches are not used. Issues rated D by Fitch or S&P, or that have been subject to a default press release by Moody's cannot enter the HY Index. Those issues in the HY Index that are subsequently downgraded to D by Fitch or S&P or subject to a default press release by Moody's (as of the bond selection cut-off date) will be taken out of the HY Index on the next rebalancing date. After a bond has migrated into high yield from investment grade status, it must retain that status for three months (the "stabilization period") before it can be included in the HY Index. In case of an ID change or exchange of a 144A version into a registered bond, the ratings from the 144A bond are also used for the registered bond.
- Time to Maturity. To qualify for entry in the HY Index, at the balancing day, bonds must have at least one year to maturity and new insertions must have at least 18 months remaining to maturity. All bonds must have an expected remaining term of 15 years or less.
- Amount Outstanding. The outstanding face value of all non-convertible bonds denominated in U.S. dollars from the issuer must be greater than or equal to $1 billion as of the bond selection cut-off date. The outstanding face value of a bond must be greater than or equal to $400 million as of the bond selection cut-off date. Partial buybacks or increases will affect the outstanding face value of a prospective bond. Markit considers changes to the outstanding face value of a candidate bond as a result of partial or full buybacks or increases, provided that Markit is aware of such changes as of the bond selection cut-off date. In the case of 144A securities that are registered as global securities, the remaining amount of the 144A version and the registered version are recombined if the bond is not exchanged in full and if the remaining amount of the 144A version reduces the amount outstanding below the eligibility threshold.
- Bond Classification. All bonds are classified based on the principal activities of the issuer and the main sources of the cash flows used to pay coupons and redemptions. Bonds must be denominated in U.S. dollars and must be corporate credit, i.e., debt instruments backed by corporate issuers that are not secured by specific assets. Debt issued by governments, sovereigns, quasi-sovereigns and government-backed or guaranteed entities is excluded. Bonds eligible for the HY index must be issued from countries classified as developed markets based on the "Markit Global Economic Development Classification," which is updated once per year.

Each bond in the HY Index is assigned to one of the following sectors: Oil & Gas, Basic Materials, Industrials, Consumer Goods, Health Care, Consumer Services, Telecommunications, Technology, Utilities, Financials and Technology.

- Lockout Period. A bond that drops out of the HY Index at the rebalancing day is excluded from re-entering the index for a three-month period. The rule for the lockout period takes precedence over the other rules for the HY Index selection. A locked out bond will not be selected, even if it qualifies for the HY Index
- Minimum Run. Any bond that enters the HY Index must remain in the HY Index for a minimum of six months, provided it is not upgraded to investment grade, defaulted or fully redeemed in that period.

Index Review

Index methodology reviews for the HY Index are performed on a periodic basis. Any material changes to the methodology governing the HY Index are published on the Markit website.

Index Rebalancing

The HY Index is rebalanced every month, on the last business day of the month. Any inclusion after the bond selection cut-off date will not be considered in the re-balancing process, but will become effective at the end of the following month. Changes to amounts outstanding and ratings are taken into account only if they are known to have taken place three business days before the end of the month. New bonds issued are taken into account if they are publicly known to settle until the last calendar day of the month, inclusive, and if their rating and amount outstanding has become known at least three trading days before the end of the month.
In a first step, the selection criteria set out above are applied to the universe of U.S. dollar-denominated bonds. Bond ratings and amount outstanding are used as of the bond selection cut-off date. Maturity dates remain fixed for the life of the bond. Only bonds with a first settlement date on or before the rebalancing date are included in the selection process. Once the eligible bond universe has been defined, the weight for each bond is determined and if necessary capped, applying an issuer cap of 3%. The weights and capping factors are determined on the last business day of each month using the end-of-month market values.

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Treatment of Special Intra-Month Events

If a bond is fully redeemed intra-month, the bond effectively ceases to exist. In all calculations, the redeemed bond is treated as cash based on the last iBoxx price, the call price or the repurchase price, as applicable. A redemption factor and redemption price are used to treat these events in the HY Index and in calculations relating thereto. In addition, the clean price of the bond is set to the redemption price, and the interest accrued until the redemption date is treated as an irregular coupon payment.

If a bond is identified as trading flat of accrued, the accrued interest on the bond is set to zero in the total return index calculation and the bond is excluded from the calculation of all bond and index analytical values.

Some bonds have predefined coupon changes that lead to a change in the annual coupon over the life of the bond. In all instances, the coupon change must be a fixed amount on top of a fixed coupon; accordingly, floating coupon bonds are not eligible for the HY Index. The two main categories of bonds with coupon changes of this nature are step-up bonds and event-driven bonds. Step-up bonds have a pre-defined coupon schedule that cannot change during the life of the bond. That coupon schedule is used in all bond calculations. Event-driven bonds' coupons may change upon the occurrence (or non-occurrence) of specified events, such as ratings changes, failure to register a bond or failure to complete a merger. In the calculation of the HY Index and the analytics, the coupon schedule as of the calculation date is used. Any events occurring after the calculation date are ignored in the determination of the applicable coupon schedule.

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iShares iBoxx $ Investment Grade Corporate Bond Fund

iShares iBoxx $ Investment Grade Corporate Bond Fund trades on the NYSE Arca, Inc. under the ticker symbol "LQD." The LQD generally invests at least 90% of its assets in securities that comprise the underlying index and at least 95% of its assets in investment-grade corporate bonds. The LQD is passively managed and employs a representative sampling strategy. The LQD's investment adviser is BlackRock Fund Advisors and the underlying index is sponsored by Markit. More information regarding the LQD can be located on the iShares website; however, information on that website is not included or incorporated by reference into this document.

The LQD is issued by the iShares Trust, a registered investment company. The LQD seeks to provide investment results that correspond generally to the price and yield performance, before fees and expenses, of its underlying index, the U.S. dollar-denominated liquid investment grade corporate bond market, as defined by the Markit iBoxx® $ Liquid Investment Grade Index (the "IG Index"). As described below, bonds issued by issuers organized in a variety of developed countries are eligible for inclusion in the IG Index.

The iBoxx® $ Liquid Investment Grade Index (the "IG Index")

The IG index is published by Markit. Markit has no obligation to continue to publish, and may discontinue publication of, the IG Index at any time.

The IG Index is designed to reflect the performance of the U.S. dollar-denominated investment grade corporate debt. The IG Index is market-value weighted with an issuer cap of 3%.

The IG Index consists of investment grade U.S. dollar-denominated bonds issued by corporate issuers from developed countries and rated by at least one of three rating services: Fitch Ratings ("Fitch"), Moody's Investors Service ("Moody's") or Standard & Poor's Rating Services ("S&P"). The IG Index composition is rebalanced once a month, after the close of business on the last business day of the rebalancing month (the "rebalancing date"). The new IG Index composition becomes effective on the first business day of the next month.

The bonds in the IG Index must meet all the criteria described below as of the close of business three business days prior to the rebalancing date, provided that the relevant bond data can be verified, at Markit's sole discretion, as of such date (the "bond selection cut-off date").

The IG Index is based on multi-sourced pricing which, depending on the structure of each market, takes into account a variety of data inputs such as transaction data, quotes from market makers and other observable data points. Prices for the bonds in the IG Index are sourced from a number of leading market makers. The received quotes are subject to a quality control process which is intended to exclude stale or off-market prices, and the quotes that pass the quality control are consolidated to the IG Index price. Additionally, the IG Index rules and their application are governed by two committees:

- Technical Committee: composed of representatives of market makers and banks. The Technical Committee meets once a month in order to provide feedback and information as to the monthly rebalancing, and to monitor market developments. It also provides assistance in the identification of eligible constituents, especially in the instance where the eligibility or the classification of a bond is unclear or contentious. Additionally, the Technical Committee discusses any market developments which may warrant index rule changes and provides recommendations on changes to the rules.
- Oversight Committee: composed of representatives from a broad range of asset managers, consultants and industry bodies. The purpose of the Oversight Committee is to review the recommendations of the Technical Committee and also to provide consultation on any market developments which may warrant rule changes.

Selection Criteria for the iBoxx $ Liquid Investment Grade Index

The following selection criteria are applied to select the constituents for the IG Index:

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Bond Type. Only fixed-rate bonds whose cash flow can be determined in advance are eligible for the IG Index. The IG Index is comprised solely of bonds. Treasury Bills and other money market instruments are not eligible. The IG Index includes only U.S. dollar denominated bonds. In particular, bonds with the following characteristics are included: fixed coupon bonds, step-up bonds with coupon schedules known at issuance (or as functions of the issuer's rating), sinking funds and amortizing bonds, medium-term notes, Rule 144A offerings with a registration right, callable bonds and putable bonds. The following instrument types are specifically excluded from the IG Index: preferred shares, optionally and mandatorily convertible bonds, subordinated bank or insurance debt with mandatory contingent conversion features or with any conversion options before the first call date, bonds with other equity features attached (e.g., options or warrants), private placements, perpetual bonds, fixed-

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to-floater bonds, floating rate notes, pay-in-kind bonds (during the pay-in-kind period), zero coupon bonds, zero step-ups (GAINS) and bonds with differences between accrual and coupon payment periods and monthly-paying bonds.

Any bond subject to a firm call or tender offer, with the exception of exchange offers, in the month immediately following the rebalancing date will be excluded from the IG Index, provided that Markit is aware of that tender offer or call as of the bond selection cut-off date.

- Credit Rating. Bonds in the IG Index must have a Markit iBoxx Rating of investment grade, which is defined as BBB- or above by S&P or Fitch or Baa3 or above by Moody's. If a bond is rated by more than one of the foregoing ratings agencies, then the Markit iBoxx Rating is the average of the provided ratings. The rating is consolidated to the nearest rating grade in accordance with the Markit iBoxx Rules. Rating notches are not used. In case of an ID change or exchange of a Rule 144A/Regulation S offering into a registered bond, the ratings from the Rule 144A/Regulation S offering are also used for the registered bond.
- Time to Maturity. To qualify for entry in the IG Index, at the balancing day, bonds must have at least three years, and all new insertions must have at least three years and six months remaining in their term.
- Amount Outstanding. The outstanding face value of all bonds (excluding fixed-to-floater and perpetual bonds) denominated in U.S. dollars from the issuer must be greater than or equal to $2 billion as of the bond selection cut-off date. The outstanding face value of a bond must be greater than or equal to $750 million as of the bond selection cut-off date. Partial buybacks or increases will affect the outstanding face value of a prospective bond. Markit considers changes to the outstanding face value of a candidate bond as a result of partial or full buybacks or increases, provided that Markit is aware of such changes as of the bond selection cut-off date. In the case of Regulation S securities that are registered as global securities, the remaining amount of the Regulation S version and the registered version are recombined if the bond is not exchanged in full and if the remaining amount of the Regulation S version reduces the amount outstanding below the eligibility threshold.
- Bond Classification. All bonds are classified based on the principal activities of the issuer and the main sources of the cash flows used to pay coupons and redemptions. Bonds must be denominated in U.S. dollars with clearance and settlement available through DTC. The securities need to be either publicly registered in the United States with the SEC or Rule 144A offerings with registration rights. Eurobonds are excluded.

Bonds must be corporate credit, i.e., debt instruments backed by corporate issuers that are not secured by specific assets. Debt issued by governments, sovereigns, quasi-sovereigns and government-backed or guaranteed entities is excluded. Bonds eligible for the IG index must be issued from countries classified as developed markets based on the "Markit Global Economic Development Classification," which is updated once per year.

Each bond in the IG Index is assigned to one of the following sectors: Consumer Goods, Consumer Services, Financials, Industrials & Materials, Telecommunication & Technology and Utilities & Energy.

- Lockout Period. A bond that drops out of the IG Index at the rebalancing day is excluded from re-entering the index for a three-month period. The rule for the lockout period takes precedence over the other rules for the IG Index selection. A locked out bond will not be selected, even if it qualifies for the IG Index
- Minimum Run. Any bond that enters the IG Index must remain in the IG Index for a minimum of six months, provided it is not downgraded to sub-investment grade, defaulted or fully redeemed in that period.

Index Review

Index methodology reviews for the IG Index are performed on a periodic basis. Any material changes to the methodology governing the IG Index are published on the Markit website.

Index Calculation

The calculation of the IG Index is based on bid prices. New bonds are included in the indices at their respective ask prices when they enter the index.

Index Rebalancing

The IG Index is rebalanced every month, on the last business day of the month after the close of business, i.e., the rebalancing date. Any inclusion after the bond selection cut-off date will not be considered in the re-balancing process, but will become effective at the end of the following month. Changes to amounts outstanding and ratings are taken into account only if they are known to have taken place three business days before the end of the month. New bonds issued are taken into account if they are publicly known to settle until the last calendar day of the month, inclusive, and if their rating and amount outstanding has become known at least three trading days before the end of the month.

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In a first step, the selection criteria set out above are applied to the universe of the broader Markit iBoxx USD Corporate Investment Grade Index. Bond ratings and amount outstanding are used as of the bond selection cut-off date. Maturity dates remain fixed for the life of the bond. Only bonds with a first settlement date on or before the rebalancing date are included in the selection process. Once the eligible bond universe has been defined, the weight for each bond is determined and if necessary capped, applying an issuer cap of 3%. The weights and capping factors are determined on the last business day of each month using the end-of-month market values.

Treatment of Special Intra-Month Events

If a bond is fully redeemed intra-month, the bond effectively ceases to exist. In all calculations, the redeemed bond is treated as cash based on the last iBoxx price, the call price or the repurchase price, as applicable. A redemption factor and redemption price is used to treat these events in the IG Index and in calculations relating thereto. In addition, the clean price of the bond is set to the redemption price, and the interest accrued until the redemption date is treated as an irregular coupon payment.

If a bond is identified as trading flat of accrued, the accrued interest on the bond is set to zero in the total return index calculation and the bond is excluded from the calculation of all bond and index analytical values.

Some bonds have predefined coupon changes that lead to a change in the annual coupon over the life of the bond. In all instances, the coupon change must be a fixed amount on top of a fixed coupon; accordingly, floating coupon bonds are not eligible for the IG Index. The two main categories of bonds with coupon changes of this nature are step-up bonds and event-driven bonds. Step-up bonds have a pre-defined coupon schedule that cannot change during the life of the bond. That coupon schedule is used in all bond calculations. Event-driven bonds' coupons may change upon the occurrence (or non-occurrence) of specified events, such as ratings changes, failure to register a bond or failure to complete a merger. In the calculation of the IG Index and the analytics, the coupon schedule as of the calculation date is used. Any events occurring after the calculation date are ignored in the determination of the applicable coupon schedule.

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HISTORICAL INFORMATION

The graphs below set forth the information relating to the historical performance of each Basket Component from January 1, 2009 to February 5, 2019.

We obtained the information in the graphs below from Bloomberg Financial Markets.

We have not independently verified the accuracy or completeness of the information obtained from Bloomberg Financial Markets. The historical performance of the Basket Components should not be taken as an indication of its future performance, and no assurance can be given as to the Final Level of any of the Basket Components. We cannot give you assurance that the performance of the Basket Components will result in any positive return on your initial investment.

SPDR S&P500 ETF Trust (SPY)

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

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iShares MSCI EAFE ETF (EFA)

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SPDR Gold Trust (GLD)

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

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iShares iBoxx $ High Yield Corporate Bond ETF (HYG)
PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

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iShares iBoxx $ Investment Grade Corporate Bond ETF (LQD)

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS

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SUPPLEMENTAL DISCUSSION OF U.S. FEDERAL INCOME TAX CONSEQUENCES

The following disclosure supplements, and to the extent inconsistent, supersedes, the discussion in the product prospectus supplement dated September 11, 2018 under “Supplemental Discussion of U.S. Federal Income Tax Consequences.”

Under Section 871(m) of the Code, a “dividend equivalent” payment is treated as a dividend from sources within the United States and such payments generally would be subject to a 30% U.S. withholding tax if paid to a non-U.S. holder. Under U.S. Treasury Department regulations, payments (including deemed payments) with respect to equity-linked instruments (“ELIs”) that are “specified ELIs” may be treated as dividend equivalents if such specified ELIs reference an interest in an “underlying security,” which is generally any interest in an entity taxable as a corporation for U.S. federal income tax purposes if a payment with respect to such interest could give rise to a U.S. source dividend. Although U.S. Treasury Department regulations provide that withholding on dividend equivalent payments will not apply to specified ELIs that are not delta-one instruments and that are issued before January 1, 2021, we have determined that the Notes are delta-one instruments. In addition, U.S. Treasury Department regulations exclude instruments linked to a “qualified index” (as defined in the applicable U.S. Treasury Department regulations) or an exchange traded fund that tracks a qualified index. Based on our determination that the Basket Components are each an exchange traded fund that tracks a qualified index, non-U.S. holders should not be subject to withholding on dividend equivalent payments, if any, under the Notes. Non-U.S. holders that enter, or have entered, into other transactions in respect of the Basket Components or the Notes should consult their tax advisors as to the application of the dividend equivalent withholding tax in the context of the Notes and their other transactions. If any payments are treated as dividend equivalents subject to withholding, we (or the applicable withholding agent) would be entitled to withhold taxes without being required to pay any additional amounts with respect to amounts so withheld.

The accompanying product prospectus supplement notes that FATCA withholding on payments of gross proceeds from a sale or redemption of Notes will only apply to payments made after December 31, 2018. That discussion is modified to reflect regulations proposed by the U.S. Treasury Department in December 2018 indicating an intent to eliminate the requirement under FATCA of withholding on gross proceeds of the disposition of financial instruments. The U.S. Treasury Department has indicated that taxpayers may rely on these proposed regulations pending their finalization. Prospective investors are urged to consult with their own tax advisors regarding the possible implications of FATCA on their investment in the Notes.

SUPPLEMENTAL PLAN OF DISTRIBUTION (CONFLICTS OF INTEREST)

We expect that delivery of the Notes will be made against payment for the Notes on or about February 28, 2019, which is the third business day following the Trade Date (this settlement cycle being referred to as “T+3”). See “Plan of Distribution” in the prospectus. For additional information as to the relationship between us and RBC Capital Markets, LLC, please see the section “Plan of Distribution—Conflicts of Interest” in the prospectus.

We expect to deliver the Notes on a date that is greater than two business days following the Trade Date. Under Rule 15c6-1 of the Exchange Act, trades in the secondary market generally are required to settle in two business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the Notes more than two business days prior to the original Issue Date will be required to specify alternative settlement arrangements to prevent a failed settlement.

The value of the Notes shown on your account statement may be based on RBCCM’s estimate of the value of the Notes if RBCCM or another of our affiliates were to make a market in the Notes (which it is not obligated to do). That estimate will be based upon the price that RBCCM may pay for the Notes in light of then prevailing market conditions, our creditworthiness and transaction costs. For a period of approximately twelve months after the issue date of the Notes, the value of the Notes that may be shown on your account statement may be higher than RBCCM’s estimated value of the Notes at that time. This is because the estimated value of the Notes will not include the underwriting discount and our hedging costs and profits; however, the value of the Notes shown on your account statement during that period may be a higher amount, reflecting the addition of RBCCM's underwriting discount and our estimated costs and profits from hedging the Notes. This excess is expected to decrease over time until the end of this period. After this period, if RBCCM repurchases your Notes, it expects to do so at prices that reflect their estimated value.

We may use this terms supplement in the initial sale of the Notes. In addition, RBCCM or another of our affiliates may use this terms supplement in a market-making transaction in the Notes after their initial sale. Unless we or our agent informs the purchaser otherwise in the confirmation of sale, this terms supplement is being used in a market-making transaction.

STRUCTURING THE NOTES

The Notes are our debt securities, the return on which is linked to the performance of the Basket Components. As is the case for all of our debt securities, including our structured notes, the economic terms of the Notes reflect our actual or perceived creditworthiness at the time of pricing. In addition, because structured notes result in increased operational, funding and liability management costs to us, we typically borrow the funds under these Notes at a rate that is more favorable to us than the rate that we might pay for a conventional fixed or floating rate debt security of comparable maturity. Using this relatively lower implied borrowing rate rather than the secondary market rate, is a factor that is likely to reduce the initial estimated value of the Notes at the time their terms are set. Unlike the estimated value included in this terms supplement or in the final pricing supplement, any value of the Notes determined for purposes of a secondary market transaction may be based on a different funding rate, which may result in a lower value for the Notes than if our initial internal funding rate were used.

In order to satisfy our payment obligations under the Notes, we may choose to enter into certain hedging arrangements (which may include call options, put options or other derivatives) on the issue date with RBCCM or one of our other subsidiaries. The terms of these hedging arrangements take into account a number of factors, including our creditworthiness, interest rate movements, the volatility of the Basket Components, and the tenor of the Notes. The economic terms of the Notes and their initial estimated value depend in part on the terms of these hedging arrangements.

The lower implied borrowing rate is a factor that reduces the economic terms of the Notes to you. The initial offering price of the Notes also reflects the underwriting commission and our estimated hedging costs. These factors result in the initial estimated value for the Notes on the Trade Date being less than their public offering price. See “Selected Risk Considerations—The Initial Estimated Value of the Notes Will Be Less than the Price to the Public” above.