NETFLIX INC
Form 10-Q
November 03, 2008
Table of Contents

UNITED STATES

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 September 30, 2008

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, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨ (do not check if a smaller reporting company)	Smaller reporting company ¨

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 October 31, 2008, there were 58,669,096 shares of the registrant s common stock, par value $0.001, outstanding.

Table of Contents

Table of Contents

		Page
Part I. Financial Information		3
Item 1.	Condensed Consolidated Financial Statements	3
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	33
Item 4.	Controls and Procedures	33
Part II. Other Information		35
Item 1.	Legal Proceedings	35
Item 1A.	Risk Factors	35
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	35
Item 6.	Exhibits	36
Signatures		37
Exhibit Index		38

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. **Condensed Consolidated Financial Statements**

Index to Condensed Consolidated Financial Statements

	Page
Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2008 and 2007	4
Condensed Consolidated Balance Sheets as of September 30, 2008 and December 31, 2007	5
Condensed Consolidated Statements of Cash Flows for the Three and Nine Months Ended September 30, 2008 and 2007	6
Notes to Condensed Consolidated Financial Statements	7

Table of Contents

Netflix, Inc.

Condensed Consolidated Statements of Operations

(unaudited)

(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Revenues	$ 341,269	$ 293,972	$ 1,005,066	$ 902,985
Cost of revenues:				
Subscription	186,573	163,707	567,498	495,734
Fulfillment expenses *	37,923	30,746	109,890	90,384
Total cost of revenues	224,496	194,453	677,388	586,118
Gross profit	116,773	99,519	327,678	316,867
Operating expenses:				
Technology and development *	23,368	18,112	65,821	52,526
Marketing *	49,217	49,149	144,096	166,508
General and administrative *	11,742	12,863	38,900	38,834
Gain on disposal of DVDs	(1,628)	(2,310)	(4,724)	(5,500)
Gain on legal settlement				(7,000)
Total operating expenses	82,699	77,814	244,093	245,368
Operating income	34,074	21,705	83,585	71,499
Other income (expense):				
Interest expense on lease financing obligations	(677)	(296)	(1,781)	(893)
Interest and other income (expense)	1,536	5,089	11,600	15,411
Income before income taxes	34,933	26,498	93,404	86,017
Provision for income taxes	14,562	10,851	33,110	35,100
Net income	$ 20,371	$ 15,647	$ 60,294	$ 50,917
Net income per share:				
Basic	$ 0.34	$ 0.24	$ 0.98	$ 0.75
Diluted	$ 0.33	$ 0.23	$ 0.95	$ 0.73
Weighted average common shares outstanding:				
Basic	60,408	66,469	61,651	67,723
Diluted	62,272	68,090	63,658	69,560
*** Stock-based compensation included in expense line items:**				
Fulfillment expenses	$ 126	$ 99	$ 340	$ 327
Technology and development	950	1,002	2,795	2,590
Marketing	460	547	1,424	1,599
General and administrative	1,499	1,465	4,511	4,218

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Netflix, Inc.

Condensed Consolidated Balance Sheets

(unaudited)

(in thousands, except share and par value data)

	As of	
	September 30, 2008	**December 31, 2007**
Assets		
Current assets:		
Cash and cash equivalents	$ 111,524	$ 177,439
Short-term investments	139,304	207,703
Prepaid expenses	9,982	6,116
Prepaid revenue sharing expenses	15,274	6,983
Deferred tax assets	7,023	2,254
Other current assets	18,268	16,037
Total current assets	301,375	416,532
Content library, net	122,558	132,455
Property and equipment, net	128,541	113,175
Deferred tax assets	19,831	16,865
Other assets	10,694	4,465
Total assets	$ 582,999	$ 683,492
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 109,277	$ 104,445
Accrued expenses	31,625	36,466
Current portion lease financing obligations	1,090	823
Deferred revenue	65,897	71,665
Total current liabilities	207,889	213,399
Lease financing obligations, excluding current portion	38,287	35,652
Other liabilities	11,990	4,629
Total liabilities	258,166	253,680
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.001 par value; 160,000,000 shares authorized at September 30, 2008 and December 31, 2007; 59,119,998 and 64,912,915 issued and outstanding at September 30, 2008 and December 31, 2007, respectively	62	65
Additional paid-in capital	331,489	402,710
Treasury stock at cost (2,991,684 shares)	(90,028)	
Accumulated other comprehensive (loss) income	(2,410)	1,611
Retained earnings	85,720	25,426
Total stockholders equity	324,833	429,812
Total liabilities and stockholders equity	$ 582,999	$ 683,492

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Netflix, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Cash flows from operating activities:				
Net income	$ 20,371	$ 15,647	$ 60,294	$ 50,917
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization of property, equipment and intangibles	8,643	5,945	23,313	16,057
Amortization of content library	47,596	48,237	162,178	148,664
Amortization of discounts and premiums on investments	122	23	436	(48)
Stock-based compensation expense	3,035	3,113	9,070	8,734
Excess tax benefits from stock-based compensation	(1,093)	(5,170)	(4,467)	(21,264)
(Gain) loss on disposal of property and equipment	(1)	128	101	128
Loss (gain) on sale of short-term investments	494	(170)	(3,746)	(364)
Gain on disposal of DVDs	(3,205)	(3,937)	(9,856)	(11,731)
Deferred taxes	(3,894)	(358)	(7,255)	(1,235)
Changes in operating assets and liabilities:				
Prepaid expenses and other current assets	(209)	111	(8,306)	(4,495)
Accounts payable	(1,056)	6,048	6,869	(387)
Accrued expenses	4,730	11,433	(1,994)	33,376
Deferred revenue	(1,989)	(4,201)	(5,768)	(13,357)
Other assets and liabilities	(313)	814	8,376	1,026
Net cash provided by operating activities	73,231	77,663	229,245	206,021
Cash flows from investing activities:				
Purchases of short-term investments	(22,950)	(51,972)	(180,841)	(370,112)
Proceeds from sale of short-term investments	50,609	41,264	247,610	165,379
Purchases of property and equipment	(9,226)	(7,412)	(36,319)	(34,393)
Acquisition of intangible asset	(62)		(1,062)	
Acquisitions of content library	(41,564)	(39,452)	(161,862)	(165,346)
Proceeds from sale of DVDs	3,787	4,760	13,673	17,756
Investment in business			(6,000)	
Other assets	3	615	31	779
Net cash used in investing activities	(19,403)	(52,197)	(124,770)	(385,937)
Cash flows from financing activities:				
Principal payments of lease financing obligations	(234)	(98)	(586)	(290)
Proceeds from issuance of common stock	2,576	417	15,642	3,864
Excess tax benefits from stock-based compensation	1,093	5,170	4,467	21,264
Repurchases of common stock	(90,028)	(35,333)	(189,913)	(65,548)
Net cash used in financing activities	(86,593)	(29,844)	(170,390)	(40,710)
Net decrease in cash and cash equivalents	(32,765)	(4,378)	(65,915)	(220,626)

Cash and cash equivalents, beginning of period	144,289	184,182	177,439	400,430
Cash and cash equivalents, end of period	$ 111,524	$ 179,804	$ 111,524	$ 179,804

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Netflix, Inc.

Notes to Condensed Consolidated Financial Statements

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 (U.S.) 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, 2007. The preparation of condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and judgments that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Examples include the estimates of useful lives and residual value of the Company s content 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 herein. The interim financial statements should be read in conjunction with the audited financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission (the SEC) on February 28, 2008. Interim results are not necessarily indicative of the results for a full year.

Fair Value of Financial Instruments

The fair value of the Company s cash and cash equivalents, short-term investments, accounts payable and accrued expenses approximates their carrying value due to their short maturities.

Cash Equivalents and Short-Term Investments

The Company classifies cash equivalents and short-term investments in accordance with the Financial Accounting Standards Board s (FASB) Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The Company considers investments in instruments purchased with an original maturity of 90 days or less to be cash equivalents. The Company classifies short-term investments as available-for-sale, which consists of marketable securities with original maturities in excess of 90 days. Short-term investments are reported at fair value with unrealized gains and losses included in accumulated other comprehensive income (loss) within stockholders equity in the condensed consolidated balance sheets. The amortization of premiums and discounts, realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in interest and other income (expense) in the condensed consolidated statements of operations. The Company uses the specific identification method to determine cost when calculating realized gains and losses upon the sale of short-term investments.

Short-term investments are reviewed periodically to identify possible other-than-temporary impairment. When evaluating the investments, the Company reviews factors such as length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and the Company s ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. The Company s short-term investments had no other-than-temporary impairment during the three and nine months ended September 30, 2008 and 2007.

Restricted Cash

As of September 30, 2008 and December 31, 2007, other assets included restricted cash of $1.9 million related to workers compensation insurance deposits. In the second quarter of 2008, the Company paid $2.4 million for plaintiffs attorneys fees and expenses in the *Chavez vs. Netflix, Inc.* lawsuit, of which $2.3 million was included in other current assets as of December 31, 2007.

Content Library

The Company acquires content from studios and distributors through direct purchases, revenue sharing agreements and license agreements. The Company acquires content for the purpose of rental to its subscribers and earns subscription rental revenues and, as such, considers its content library to be a productive asset. Accordingly, the Company classifies its content library as a non-current asset in its condensed consolidated balance sheets. Additionally, in accordance with SFAS No. 95, *Statement of Cash Flows*, cash outflows for the acquisition of the content library, net of changes in accounts payable, are classified as cash flows from investing activities in the Company s condensed consolidated statements of

cash flows. This is inclusive of any upfront non-refundable payments required under revenue sharing agreements.

Table of Contents

The Company amortizes its DVDs, less estimated salvage value, on a sum-of-the-months accelerated basis over their estimated useful lives. The useful lives of new release and catalog DVDs are estimated to be one year and three years, respectively. In estimating the useful lives of the DVDs, the Company takes into account library utilization as well as an estimate for lost or damaged DVDs. Volume purchase discounts received from studios on the purchase of titles are recorded as a reduction of DVD inventory when earned.

The Company provides a salvage value of $3.00 per DVD for direct purchase DVDs that the Company estimates it will sell at the end of their useful lives. For DVDs that the Company does not expect to sell, no salvage value is provided.

Under revenue sharing agreements with studios and distributors, the Company generally obtains titles for a low initial cost in exchange for a commitment to share a percentage of its subscription revenues or a fee, based on utilization, over a fixed period, or the title term, which typically ranges from six to twelve months for each DVD title. The revenue sharing expense associated with the use of each title is expensed to cost of revenues. At the end of the title term, the Company generally has the option of returning the DVD title to the studio, destroying the title or purchasing the title. In addition, the Company remits an upfront non-refundable payment to acquire titles from the studios and distributors under revenue sharing agreements. This payment includes a contractually specified initial fixed license fee that is capitalized and amortized in accordance with the Company s DVD amortization policy. This payment may also include a contractually specified prepayment of future revenue sharing obligations that is classified as prepaid revenue sharing expense and is charged to expense as future revenue sharing obligations are incurred.

The Company offers movies and TV episodes that can be watched on subscribers PCs and TVs via Netflix ready devices (streaming content). The Company capitalizes and amortizes license fees on streaming content on a straight-line basis consistent with the terms of the license agreements. Streaming content is also acquired under revenue sharing agreements with studios and distributors. The revenue sharing expense associated with the streaming of content is expensed to cost of revenues.

Amortization of Intangible Assets

Intangible assets are carried at cost less accumulated amortization. The Company amortizes intangible assets with finite lives using the straight-line method over the estimated economic lives of the assets, ranging from approximately 9 to 14 years. Intangible assets are included in other assets in the condensed consolidated balance sheets. See Note 4 to the condensed consolidated financial statements for further discussion.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the shorter of the estimated useful lives of the respective assets, generally up to 30 years, or the lease term for leasehold improvements, if applicable. See Note 4 to the condensed consolidated financial statements for further discussion.

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as content library, property and equipment and intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of asset groups to be held and used is measured by a comparison of the carrying amount of an asset group to estimated undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized for the amount in which the carrying amount of an asset group exceeds fair value of the asset group. Impairment charges were not material during the three and nine months ended September 30, 2008 and 2007.

Capitalized Software Costs

The Company accounts for software development costs, including costs to develop software products or the software component of products to be marketed to external users, as well as software programs to be used solely to meet the Company s internal needs in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* and Statement of Position (SOP) No. 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*. Costs incurred during the application development stage for software programs to be used solely to meet the Company s internal needs are capitalized. Capitalized software costs are included in property and equipment, net and are amortized over the estimated useful lives of the software, generally up to three years. The net book value of capitalized software costs is not significant as of September 30, 2008 and December 31, 2007.

Table of Contents

Revenue Recognition

Subscription revenues are recognized ratably over each subscriber s monthly subscription period. Revenues are presented net of the taxes that are collected from customers and remitted to governmental authorities. Refunds to subscribers are recorded as a reduction of revenues. Revenues from advertising sales are recognized upon completion of the related campaign. Deferred revenue consists of subscription revenues billed to subscribers that have not been recognized and gift subscriptions that have not been redeemed.

Cost of Revenues

Subscription. Cost of subscription revenues consists of postage and packaging expenses, amortization of the content library and revenue sharing expenses. Revenue sharing expenses are recorded when DVDs are shipped to subscribers or subscribers watch streaming content.

The terms of some revenue sharing agreements with studios obligate the Company to make minimum revenue sharing payments for certain titles. The Company amortizes minimum revenue sharing prepayments (or accretes an amount payable to studios if the payment is due in arrears) as revenue sharing obligations are incurred. A provision for estimated shortfall, if any, on minimum revenue sharing payments is made in the period in which the shortfall becomes probable and can be reasonably estimated. Additionally, the terms of certain purchase agreements with studios provide for rebates based on achieving specified performance levels. The Company accrues for these rebates as earned based on historical title performance and estimates of demand for the titles over the remainder of the title term. Actual rebates may vary which could result in an increase or reduction in the estimated amounts previously accrued.

Fulfillment expenses. Fulfillment expenses represent costs incurred in operating and staffing the Company s shipping centers and customer service location, including costs attributable to receiving, inspecting and warehousing the Company s content library. Fulfillment expenses also include credit card fees.

Technology and Development

Technology and development expenses consist of payroll and related costs incurred in testing, maintaining and modifying the Company s Web site, recommendation service, telecommunications systems and infrastructure. Technology and development expenses also include costs incurred related to improvements for the delivery of streaming content, other internal-use software systems and the depreciation of the computer hardware and capitalized software used to run the Company s Web site and store its data.

Marketing

Marketing expenses consist primarily of advertising costs. Advertising costs include marketing program expenditures and other promotional activities, including revenue sharing expenses, postage and packaging expenses and content amortization related to free trial periods. Advertising costs are expensed as incurred except for advertising production costs, which are expensed the first time the advertising is run.

The Company and its vendors participate in a variety of cooperative advertising programs and other promotional programs in which the vendors provide the Company with cash consideration in exchange for marketing and advertising of the vendor s products. If the consideration received represents reimbursement of specific incremental and identifiable costs incurred to promote the vendor s product, it is recorded as an offset to the associated marketing expense incurred. Any reimbursement greater than the specific incremental and identifiable costs incurred is recognized as a reduction in cost of revenues in the Company s condensed consolidated statements of operations.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Deferred income taxes are recognized by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for any tax benefits for which future realization is uncertain. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

Comprehensive Income (Loss)

The Company reports comprehensive income or loss in accordance with the provisions of SFAS No. 130, *Reporting Comprehensive Income*, which establishes standards for reporting comprehensive income and its components in the financial statements. Comprehensive income (loss) consists of unrealized gains and losses on available-for-sale securities, net of tax.

Table of Contents

Net Income Per Share

Basic net income per share is computed using the weighted-average number of outstanding shares of common stock during the period. Diluted net income per share is computed using the weighted-average number of outstanding shares of common stock and, when dilutive, potential common shares outstanding during the period. Potential common shares consist primarily of incremental shares issuable upon the assumed exercise of stock options and shares currently purchasable pursuant to the Company s employee stock purchase plan using the treasury stock method. The computation of net income per share is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	(in thousands, except per share data)			
Basic earnings per share:				
Net income	$ 20,371	$ 15,647	$ 60,294	$ 50,917
Shares used in computation:				
Weighted-average common shares outstanding	60,408	66,469	61,651	67,723
Basic earnings per share	$ 0.34	$ 0.24	$ 0.98	$ 0.75
Diluted earnings per share:				
Net income	$ 20,371	$ 15,647	$ 60,294	$ 50,917
Shares used in computation:				
Weighted-average common shares outstanding	60,408	66,469	61,651	67,723
Employee stock options and employee stock purchase plan shares	1,864	1,621	2,007	1,837
Weighted-average number of shares	62,272	68,090	63,658	69,560
Diluted earnings per share	$ 0.33	$ 0.23	$ 0.95	$ 0.73

Employee stock options with exercise prices greater than the average market price of the common stock were excluded from the diluted calculation as their inclusion would have been anti-dilutive. The following table summarizes the potential common shares excluded from the diluted calculation:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	(in thousands)			
Employee stock options	555	2,660	458	2,071

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment*. Vested stock options granted before June 30, 2004 can be exercised up to three months following termination of employment. Vested stock options granted after June 30, 2004 and before January 1, 2007 can be exercised up to one year following termination of employment. Beginning in January 2007, newly-granted employee stock options can be exercised for the full ten year contractual term regardless of employment status. In conjunction with this change, the Company changed its method of calculating the fair value of new stock-based compensation awards granted under its stock option plans from a Black-Scholes model to a lattice-binomial model. See Note 6 to the condensed consolidated financial statements for further discussion.

Recent Accounting Pronouncements

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles.* SFAS No. 162 identifies the sources of accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in

conformity with GAAP in the U.S. (the GAAP hierarchy). SFAS 162 is effective 60 days following the SEC approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles* . The Company currently adheres to the GAAP hierarchy as presented in SFAS No. 162, and does not expect the adoption of this standard to have a material impact on its financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, to replace SFAS No. 141, *Business Combinations*. SFAS No. 141(R) requires the use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and broadens the scope to all transactions and other events in which one entity obtains control over one or more other businesses. This statement is effective for financial statements issued for fiscal years beginning on or after December 15, 2008. The Company does not expect the adoption of this standard to have a material impact on its financial position or results of operations.

Table of Contents

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 allows companies to choose to measure many financial instruments and certain other items at fair value. The statement requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 also amends certain provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. SFAS No. 159 was effective for the Company beginning in the first quarter of fiscal 2008. The Company elected to account for the investment in a business under the cost method during the first quarter of 2008. The adoption of SFAS No. 159 in the first quarter of fiscal 2008 did not impact the Company s financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2, which delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for items within the scope of FSP No. 157-2. Effective January 1, 2008, the Company adopted SFAS No. 157 for financial assets and liabilities recognized at fair value on a recurring basis. The partial adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on the Company s financial position or results of operations. In October 2008, the FASB issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. FSP No. 157-3 clarifies the application of SFAS No. 157 in cases where a market is not active. The Company has considered FSP No. 157-3 in its determination of estimated fair values as of September 30, 2008, and the impact was not material. See Note 3 to the condensed consolidated financial statements for further discussion.

2. Immaterial Error Corrections

In June 2004, the Company entered into a lease arrangement whereby the Company leased a building that was constructed by a third party. In June 2006, the Company entered into a similar lease arrangement whereby the Company leased a second building that was constructed by the same third party. Upon commencement of the leases, the Company accounted for both of these arrangements as operating leases under SFAS No. 13, *Accounting for Leases*, whereby the total minimum lease payment obligations under the leases were recognized as monthly rent expense on a straight-line basis over the terms of the leases.

In June 2008, it was determined that because the terms of the original lease agreements required the Company s involvement in the construction of certain elements of the buildings, under Emerging Issues Task Force (EITF) No. 97-10, *The Effect of Lessee Involvement in Asset Construction*, the Company was deemed to be the owner (for accounting purposes only) of the buildings subject to the leases during the construction period. The Company should have reflected an asset on its balance sheet for the costs paid by the lessor to construct these buildings, as well as a corresponding liability. Upon completion of construction, the Company did not meet the sale-leaseback criteria under SFAS No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases; an amendment of FASB Statements No. 13, 66, and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11*, and therefore should have treated the leases as financing obligations and the assets and corresponding liabilities would not be derecognized.

The corrections to the historical financial statements to apply EITF No. 97-10 were considered immaterial and did not affect the total cash payments the Company has made or is obligated to make under the lease agreements, nor did it change the total expense to be recognized over the lease terms. However, the timing and nature of expense is different under this treatment as compared to operating lease treatment. Specifically, the Company should have recognized land lease expense, depreciation expense on the assets it is deemed to own and interest expense on the associated lease financing obligations.

As of September 30, 2008, property and equipment, net, included $40.7 million for the two buildings described above and related accumulated depreciation of $2.2 million. As of December 31, 2007, property and equipment, net, included $37.2 million and related accumulated depreciation of $1.3 million.

Table of Contents

The impact of these corrections on the previously presented periods is as follows:

Netflix, Inc.

Condensed Consolidated Statements of Operations

(unaudited)

(in thousands, except per share data)

	Three Months Ended September 30, 2007	Adjustments	Adjusted Three Months Ended September 30, 2007
Revenues	$ 293,972	$	$ 293,972
Cost of revenues:			
Subscription	163,707		163,707
Fulfillment expenses	30,746		30,746
Total cost of revenues	194,453		194,453
Gross profit	99,519		99,519
Operating expenses:			
Technology and development	18,216	(104)	18,112
Marketing	49,166	(17)	49,149
General and administrative	12,895	(32)	12,863
Gain on disposal of DVDs	(2,310)		(2,310)
Total operating expenses	77,967	(153)	77,814
Operating income	21,552	153	21,705
Other income (expense):			
Interest expense on lease financing obligations		(296)	(296)
Interest and other income (expense)	5,089		5,089
Income before income taxes	26,641	(143)	26,498
Provision for income taxes	10,909	(58)	10,851
Net income	$ 15,732	$ (85)	$ 15,647
Net income per share:			
Basic	$ 0.24		$ 0.24
Diluted	$ 0.23		$ 0.23
Weighted average common shares outstanding:			
Basic	66,469		66,469
Diluted	68,090		68,090

Table of Contents

Netflix, Inc.

Condensed Consolidated Statements of Operations

(unaudited)

(in thousands, except per share data)

	Nine Months Ended September 30, 2007	Adjustments	Adjusted Nine Months Ended September 30, 2007
Revenues	$ 902,985	$	$ 902,985
Cost of revenues:			
Subscription	495,734		495,734
Fulfillment expenses	90,384		90,384
Total cost of revenues	586,118		586,118
Gross profit	316,867		316,867
Operating expenses:			
Technology and development	52,838	(312)	52,526
Marketing	166,559	(51)	166,508
General and administrative	38,930	(96)	38,834
Gain on disposal of DVDs	(5,500)		(5,500)
Gain on legal settlement	(7,000)		(7,000)
Total operating expenses	245,827	(459)	245,368
Operating income	71,040	459	71,499
Other income (expense):			
Interest expense on lease financing obligations		(893)	(893)
Interest and other income (expense)	15,411		15,411
Income before income taxes	86,451	(434)	86,017
Provision for income taxes	35,275	(175)	35,100
Net income	$ 51,176	$ (259)	$ 50,917
Net income per share:			
Basic	$ 0.76		$ 0.75
Diluted	$ 0.74		$ 0.73
Weighted average common shares outstanding:			
Basic	67,723		67,723
Diluted	69,560		69,560

Table of Contents

Netflix, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Three Months Ended September 30, 2007	Adjustments	Adjusted Three Months Ended September 30, 2007
Cash flows from operating activities:			
Net income	$ 15,732	$ (85)	$ 15,647
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of property, equipment and intangibles	5,777	168	5,945
Amortization of content library	48,237		48,237
Amortization of discounts and premiums on investments	23		23
Stock-based compensation expense	3,113		3,113
Excess tax benefits from stock-based compensation	(5,170)		(5,170)
Loss on disposal of property and equipment	128		128
Gain on sale of short-term investments	(170)		(170)
Gain on disposal of DVDs	(3,937)		(3,937)
Deferred taxes	(300)	(58)	(358)
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	111		111
Accounts payable	6,048		6,048
Accrued expenses	11,433		11,433
Deferred revenue	(4,201)		(4,201)
Other assets and liabilities	741	73	814
Net cash provided by operating activities	77,565	98	77,663
Cash flows from investing activities:			
Purchases of short-term investments	(51,972)		(51,972)
Proceeds from sale of short-term investments	41,264		41,264
Purchases of property and equipment	(7,412)		(7,412)
Acquisitions of content library	(39,452)		(39,452)
Proceeds from sale of DVDs	4,760		4,760
Other assets	615		615
Net cash used in investing activities	(52,197)		(52,197)
Cash flows from financing activities:			
Principal payments of lease financing obligations		(98)	(98)
Proceeds from issuance of common stock	417		417
Excess tax benefits from stock-based compensation	5,170		5,170
Repurchases of common stock	(35,333)		(35,333)
Net cash used in financing activities	(29,746)	(98)	(29,844)
Net decrease in cash and cash equivalents	(4,378)		(4,378)

Cash and cash equivalents, beginning of period		184,182		184,182
Cash and cash equivalents, end of period	$	179,804	$	$ 179,804

Table of Contents

Netflix, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Nine Months Ended September 30, 2007	Adjustments	Adjusted Nine Months Ended September 30, 2007
Cash flows from operating activities:			
Net income	$ 51,176	$ (259)	$ 50,917
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of property, equipment and intangibles	15,553	504	16,057
Amortization of content library	148,664		148,664
Amortization of discounts and premiums on investments	(48)		(48)
Stock-based compensation expense	8,734		8,734
Excess tax benefits from stock-based compensation	(21,264)		(21,264)
Loss on disposal of property and equipment	128		128
Gain on sale of short-term investments	(364)		(364)
Gain on disposal of DVDs	(11,731)		(11,731)
Deferred taxes	(1,060)	(175)	(1,235)
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(4,495)		(4,495)
Accounts payable	(387)		(387)
Accrued expenses	33,376		33,376
Deferred revenue	(13,357)		(13,357)
Other assets and liabilities	806	220	1,026
Net cash provided by operating activities	205,731	290	206,021
Cash flows from investing activities:			
Purchases of short-term investments	(370,112)		(370,112)
Proceeds from sale of short-term investments	165,379		165,379
Purchases of property and equipment	(34,393)		(34,393)
Acquisitions of content library	(165,346)		(165,346)
Proceeds from sale of DVDs	17,756		17,756
Other assets	779		779
Net cash used in investing activities	(385,937)		(385,937)
Cash flows from financing activities:			
Principal payments of lease financing obligations		(290)	(290)
Proceeds from issuance of common stock	3,864		3,864
Excess tax benefits from stock-based compensation	21,264		21,264
Repurchases of common stock	(65,548)		(65,548)
Net cash used in financing activities	(40,420)	(290)	(40,710)
Net decrease in cash and cash equivalents	(220,626)		(220,626)
Cash and cash equivalents, beginning of period	400,430		400,430

Cash and cash equivalents, end of period	$ 179,804	$	$ 179,804

The Company has also corrected immaterial errors in its previously filed Form 10-K for the year ended December 31, 2007 and will report the adjusted amounts the next time these periods are reported. Net income was reduced by $0.3 million, $0.2 million and $0.1 million for the years ended December 31, 2007, 2006 and 2005, respectively. Net income per share remained unchanged for the years ended December 31, 2007, 2006 and 2005. Total assets were increased by $24.2 million, total liabilities were increased by $24.8 million and shareholders equity was reduced by $0.6 million at December 31, 2006. Cash provided by operating activities and cash used in financing activities were increased by $0.4 million and $0.3 million for the years ended December 31, 2007 and 2006, respectively. Cash provided by operating activities and cash used in financing activities remained unchanged for the year ended December 31, 2005.

Table of Contents

3. Short-Term Investments and Fair Value Measurement

Short-term investments are classified as available-for-sale securities and are reported at fair value as follows:

	September 30, 2008			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Corporate debt securities	$ 28,571	$ 76	$ (1,275)	$ 27,372
Government and agency securities	89,999	286	(361)	89,924
Asset and mortgage-backed securities	23,144	56	(1,192)	22,008
	$ 141,714	$ 418	$ (2,828)	$ 139,304

	December 31, 2007			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Corporate debt securities	$ 36,445	$ 315	$ (85)	$ 36,675
Government and agency securities	130,884	2,155	(33)	133,006
Asset and mortgage-backed securities	37,842	307	(127)	38,022
	$ 205,171	$ 2,777	$ (245)	$ 207,703

The Company measures certain financial assets at fair value on a recurring basis, including cash equivalents and available-for-sale securities. In accordance with SFAS No. 157, fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS No. 157 establishes a three-level hierarchy which prioritizes the inputs used in measuring fair value. The three hierarchy levels are defined as follows:

Level 1 Valuations based on unadjusted quoted prices in active markets for identical assets. The fair value of available-for-sale securities included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. The Level 1 category includes money market funds of $42.9 million, which are included in cash and cash equivalents in the condensed consolidated balance sheets.

Level 2 Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of available-for-sale securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well established independent pricing vendors and broker-dealers. The Level 2 category includes short-term investments and cash equivalents of $158.9 million, which are comprised of corporate debt securities, government and agency securities and asset and mortgage-backed securities. Substantially all of the residential and commercial mortgage-backed securities are AAA rated. The mortgage bonds owned represent the senior tranches of the capital structure and provide credit enhancement through over-collateralization and their subordination characteristics.

Level 3 Valuations based on inputs that are unobservable and involve management judgment and the reporting entity s own assumptions about market participants and pricing. The Company has no Level 3 financial assets measured at fair value on the condensed consolidated balance sheets as of September 30, 2008.

The hierarchy level assigned to each security in the Company s available-for-sale portfolio and cash equivalents is based on its assessment of the transparency and reliability of the inputs used in the valuation of such instrument at the measurement date. The Company did not have any material financial liabilities that were covered by SFAS No. 157 as of September 30, 2008.

16

Table of Contents

4. Balance Sheet Components

Content Library, net

Content library and accumulated amortization consisted of the following:

	As of	
	September 30, 2008	December 31, 2007
	(in thousands)	
Content library, gross	$ 831,734	$ 698,704
Less accumulated amortization	(709,176)	(566,249)
Content library, net	$ 122,558	$ 132,455

Property and Equipment, net

Property and equipment and accumulated depreciation consisted of the following:

		As of	
		September 30, 2008	December 31, 2007
		(in thousands)	
Computer equipment	3 years	$ 42,040	$ 35,585
Other equipment	3-5 years	56,817	41,140
Computer software, including internal-use software	1-3 years	29,855	22,058
Furniture and fixtures	3 years	12,073	7,882
Building (1)	30 years	40,681	37,193
Leasehold improvements	Over life of lease	32,531	18,440
Capital work-in-progress		4,294	18,452
Property and equipment, gross		218,291	180,750
Less: Accumulated depreciation		(89,750)	(67,575)
Property and equipment, net		$ 128,541	$ 113,175

(1) See Note 2 to the condensed consolidated financial statements for further discussion.

Intangible Assets

Intangible assets and accumulated amortization consisted of the following:

	As of	
	September 30, 2008	December 31, 2007
	(in thousands)	
Patents, gross	$ 2,229	$ 1,566
Less accumulated amortization	(331)	(200)

Patents, net	$ 1,898	$ 1,366

In 2008, the Company capitalized $0.7 million related to the acquisition of certain technology patent licenses. The capitalized patent licenses are being amortized to technology and development in the condensed consolidated statements of operations over the remaining life of the patents, the last of which expires in September 2021.

Table of Contents

5. Other Comprehensive Income

The components of comprehensive income are as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	(in thousands)			
Net income	$ 20,371	$ 15,647	$ 60,294	$ 50,917
Other comprehensive income:				
Change in unrealized gain (loss) on available-for-sale securities, net of tax	(1,596)	1,258	(4,021)	737
Comprehensive income	$ 18,775	$ 16,905	$ 56,273	$ 51,654

6. Stockholders Equity

Stock Repurchases

On March 5, 2008, the Company s Board of Directors authorized a stock repurchase program allowing the Company to repurchase up to $150 million of its common stock through the end of 2008. During the three months ended September 30, 2008, the Company repurchased 2,991,684 shares of common stock under this program. Shares were purchased at an average price of approximately $30 per share for an aggregate amount of approximately $90 million. As the ultimate disposition has not been decided, repurchased shares under this plan are recorded as treasury stock under the cost method. As of September 30, 2008, there were no unsettled share repurchases.

On January 31, 2008, the Company s Board of Directors authorized a stock repurchase program allowing the Company to repurchase up to $100 million of its common stock through the end of 2008. During the three months ended March 31, 2008, the Company repurchased 3,847,062 shares of common stock under this program. Shares were purchased at an average price of approximately $26 per share for an aggregate amount of $100 million. Repurchased shares under this plan were accounted for under the retirement method, as all shares repurchased had been retired.

On April 17, 2007, the Company s Board of Directors authorized a stock repurchase program allowing the Company to repurchase up to $100 million of its common stock through the end of 2007. During the three months ended September 30, 2007, the Company repurchased 2,061,687 shares of common stock at an average price of approximately $17 per share for an aggregate amount of approximately $35 million. During the nine months ended September 30, 2007, the Company repurchased 3,444,149 shares of common stock at an average price of approximately $19 per share for an aggregate amount of $66 million. During the year ended December 31, 2007, the Company repurchased 4,733,788 shares of common stock at an average price of approximately $21 per share for an aggregate amount of $100 million. Repurchased shares under this plan were accounted for under the retirement method, as all shares repurchased had been retired.

Employee Stock Purchase Plan

In February 2002, the Company adopted the 2002 Employee Stock Purchase Plan (ESPP), which reserved a total of 1,166,666 shares of common stock for issuance. The 2002 ESPP also provides for annual increases in the number of shares available for issuance on the first day of each year, beginning with 2003, equal to the lesser of:

2 percent of the outstanding shares of the common stock on the first day of the applicable year;

666,666 shares; and

such other amount as the Company s Board of Directors may determine.

Under the Company s ESPP, employees may purchase common stock of the Company through accumulated payroll deductions. The purchase price of the common stock acquired by employees participating in the ESPP is 85% of the closing price on either the first day of the offering period or the last day of the purchase period, whichever is lower. Through May 1, 2006, offering periods were 24 months, and the purchase periods were six months. Therefore, each offering period included four six-month purchase periods, and the purchase price for each six-month period was determined by comparing the closing prices on the first day of the offering period and the last day of the applicable purchase period. In this manner, the look-back for determining the purchase price was up to 24 months. However, effective May 1, 2006, the ESPP was amended so that the offering and purchase periods take place concurrently in consecutive six-month increments. Therefore, under the amended ESPP, the look-back for determining the purchase price is six months. Employees may invest up to 15% of their gross salary through payroll deductions. In no event shall an employee be permitted to purchase more than 8,334 shares of common stock during any six-month purchase period. As of September 30, 2008, 2,525,464 shares were available for future issuance under the ESPP.

Table of Contents

Stock Option Plans

The 1997 Stock Plan provides for the issuance of stock purchase rights, incentive stock options or non-statutory stock options. In November 2007, the 1997 Stock Plan expired and, as a result, there were no shares available for grant, thereafter, under the 1997 Stock Plan.

In February 2002, the Company adopted the 2002 Stock Plan, which was amended and restated in May 2006. The 2002 Stock Plan provides for the grant of incentive stock options to employees and for the grant of non-statutory stock options and stock purchase rights to employees, directors and consultants. As of September 30, 2008, 3,437,268 shares were available for grant under the 2002 Stock Plan.

A summary of option activity during the nine months ended September 30, 2008 is as follows:

		Options Outstanding			
	Shares Available For Grant	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balances as of December 31, 2007	3,994,866	5,619,638	$ 16.47		
Granted	(217,942)	217,942	27.30		
Exercised		(484,431)	17.63		
Cancelled	30,384	(30,384)	28.61		
Expired	(332)				
Balances as of March 31, 2008	3,806,976	5,322,765	16.74	6.50	$ 95,556
Granted	(177,253)	177,253	32.58		
Exercised		(254,852)	8.50		
Cancelled	5,581	(5,581)	33.97		
Balances as of June 30, 2008	3,635,304	5,239,585	17.66	6.50	$ 49,657
Granted	(203,843)	203,843	28.97		
Exercised		(201,079)	12.81		
Cancelled	5,807	(5,807)	28.54		
Balances as of September 30, 2008	3,437,268	5,236,542	18.27	6.43	$ 67,521
Vested and exercisable as of September 30, 2008		5,236,542	18.27	6.43	67,521

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company s closing stock price on the last trading day of the third quarter of 2008 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2008. This amount changes based on the fair market value of the Company s common stock. Total intrinsic value of options exercised during the three and nine months ended September 30, 2008 was $3.5 million and $16.7 million, respectively. Total intrinsic value of options exercised during the three and nine months ended September 30, 2007 was $1.3 million and $6.6 million, respectively.

Cash received from option exercises and purchases under the ESPP for the three and nine months ended September 30, 2008 was $2.6 million and $15.6 million, respectively. Cash received from option exercises and purchases under the ESPP for the three and nine months ended September 30, 2007 was $0.4 million and $3.9 million, respectively.

Table of Contents

Stock-Based Compensation

The following table summarizes the assumptions used to value option grants using the lattice-binomial model:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Dividend Yield				
Expected Volatility	50%	48%	50% - 54%	43% - 48%
Risk-free interest rate	4.00%	4.92%	3.69% - 4.00%	4.65% - 4.92%
Suboptimal exercise factor	1.77 - 1.90	1.77 - 2.06	1.77 - 2.04	1.77 - 2.09

The fair value of shares issued under the ESPP is estimated using the Black-Scholes option pricing model. The following table summarizes the assumptions used to value shares issued under the ESPP:

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Dividend yield		
Expected volatility	55%	41%
Risk-free interest rate	1.58%	5.07%
Expected life (in years)	0.5	0.5

The Company estimates expected volatility based on a blend of historical volatility of the Company s common stock and implied volatility of tradable forward call options to purchase shares of its common stock. The Company believes that implied volatility of publicly traded options in its common stock is expected to be more reflective of market conditions and, therefore, can reasonably be expected to be a better indicator of expected volatility than historical volatility of its common stock.

The Company bifurcates its option grants into two employee groupings (executive and non-executive) based on exercise behavior and considers several factors when determining the estimate of expected life for each group, including the historical option exercise behavior and the terms and vesting periods of the options granted. In the nine months ended September 30, 2008, the Company used a suboptimal exercise factor ranging from 1.90 to 2.04, for executives and 1.77 for non-executives, which resulted in a calculated expected life of the option grants of four years for executives and three years for non-executives. In the nine months ended September 30, 2007, the Company used a suboptimal exercise factor ranging from 2.06 to 2.09 for executives and 1.77 for non-executives, which resulted in a calculated expected life of five years for executives and four years for non-executives.

The Company bases the risk-free interest rate on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term of the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The Company does not use a post-vesting termination rate as options are fully vested upon grant date.

The weighted-average fair value of employee stock options granted during the three and nine months ended September 30, 2008 was $12.40 and $12.89 per share, respectively. The weighted-average fair value of employee stock options granted during the three and nine months ended September 30, 2007 was $8.15 and $9.34 per share, respectively.

Table of Contents

The following table summarizes stock-based compensation expense, net of tax, related to stock option plans and ESPP under SFAS No. 123(R) for the three and nine months ended September 30, 2008 and 2007 which was allocated as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	(in thousands)			
Fulfillment expenses	$ 126	$ 99	$ 340	$ 327
Technology and development	950	1,002	2,795	2,590
Marketing	460	547	1,424	1,599
General and administrative	1,499	1,465	4,511	4,218
Stock-based compensation expense before income taxes	3,035	3,113	9,070	8,734
Income tax benefit	(1,266)	(1,276)	(3,298)	(3,560)
Stock-based compensation after income taxes	$ 1,769	$ 1,837	$ 5,772	$ 5,174

7. Income Taxes

The effective tax rate for the three months ended September 30, 2008 was 41.7%. The provision is primarily for the U.S. federal and state taxes netted with the research and development credits claimed during the year. Our effective tax rate differed from the federal statutory rate primarily due to state tax provision netted with the research and development credits claimed. The provision for income taxes for the three months ended September 30, 2008 was $14.6 million.

As of January 1, 2008, the Company had no gross unrecognized tax benefits. During the nine months ended September 30, 2008, the Company had an increase in gross unrecognized tax benefits of approximately $1.5 million related to its current year tax position and an increase of approximately $9.0 million related to its prior year tax positions. The gross uncertain tax positions, if recognized by the Company, will result in a reduction of approximately $8.0 million to the tax provision which will favorably impact the Company s effective tax rate.

In accordance with FIN No. 48, the Company recognizes interest and penalties related to uncertain tax positions in income tax expense. Accrued interest and penalties relating to the income tax on the unrecognized tax benefits as of September 30, 2008 were immaterial due to sufficient tax attributes or tax payments available for years prior to fiscal 2008.

The Company anticipates settling $0.3 million of its unrecognized tax benefits over the next twelve months. As a result, this amount was included in the current income payable.

Due to the Company s taxable loss position in prior years, all tax years are open to examination in the U.S and state jurisdictions. The Company is also open to examination in various state jurisdictions for tax years 2000 and forward, none of which were individually material. The Company does not anticipate the total amount of its unrecognized tax benefits to significantly change over the next twelve months.

8. Legal Proceedings

From time to time, in the normal course of its operations, the Company is a party to litigation matters and claims, including claims relating to employee relations and business practices. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict and the Company cannot reasonably estimate the likelihood or potential dollar amount of any adverse results. The Company expenses legal fees as incurred. Listed below are material legal proceedings to which the Company is a party. An unfavorable outcome of any of these matters could have a material adverse effect on the Company s financial position, liquidity or results of operations.

On October 24, 2008, Media Queue, LLC filed a complaint for patent infringement against the Company in the United States District Court for the Eastern District of Oklahoma, captioned *Media Queue, LLC v. Netflix, Inc., et. al*, Civil Action No. CIV 08-402-KEW. The complaint alleges that the Company infringed U.S. Patent No. 7,389,243 entitled Notification System and Method for Media Queue issued on June 17, 2008. The complaint seeks unspecified compensatory and enhanced damages, interest and fees, and seeks to permanently enjoin the defendants from infringing the patent in the future.

21

Table of Contents

On August 27, 2007, plaintiff/relator Norman Baccash, on behalf of the United States, filed suit against the Company in the United States District Court for the Northern District of Georgia, alleging claims under the False Claims Act, 31 U.S.C. § 3729 et seq. (the Act). The complaint was filed under seal, pursuant to the Act, to provide the United States an opportunity to intervene and conduct the action on its own. On June 26, 2008, the United States declined to intervene in the litigation and the complaint was ordered unsealed on July 11, 2008. The complaint alleges that the Company falsely certified that its DVD mailers qualified as machinable under the mailing standards of the United States Postal Service, thereby avoiding $260 million in surcharges for nonmachinable mail. The complaint seeks monetary relief in amount three times the damages suffered by United States, civil penalties of between $5,500 and $11,000 for each violation of the Act, a monetary award for the relator pursuant to the Act, injunctive relief and costs.

On December 28, 2007, Parallel Networks, LLC filed a complaint for patent infringement against the Company in the United States District Court for the Eastern District of Texas, captioned *Parallel Networks, LLC v. Netflix, Inc., et. al*, Civil Action No 2:07-cv-562-LED. The complaint alleges that the Company infringed U.S. Patent Nos. 5,894,554 and 6,415,335 B1 entitled System For Managing Dynamic Web Page Generation Requests by Intercepting Request at Web Server and Routing to Page Server Thereby Releasing Web Server to Process Other Requests and System and Method for Managing Dynamic Web Page Generation Requests , issued on April 13, 1999 and July 2, 2002, respectively. The complaint seeks unspecified compensatory and enhanced damages, interest and fees, and seeks to permanently enjoin the defendants from infringing the patent in the future.

On October 16, 2007, Refined Recommendation Corporation filed a complaint for patent infringement against the Company in the United States District Court for the Eastern District of New Jersey, captioned *Refined Recommendation Corporation v. Netflix, Inc.,* Civil Action No. 2:07-cv-04981-DMC-MF. The complaint alleges that the Company infringed U.S. Patent No. 6,606,102 entitled Optimizing Interest Potential , issued on August 12, 2003. The complaint seeks unspecified compensatory and enhanced damages, interest and fees, and seeks to permanently enjoin the defendants from infringing the patent in the future. On February 15, 2008, the case was transferred to the Northern District of California. On September 16, 2008, the Company entered into a settlement agreement with the plaintiff. On September 24, 2008, pursuant to a stipulation between the parties, the court entered an Order dismissing all claims against the Company with prejudice.

On January 2, 2007, Lycos, Inc. filed a complaint for patent infringement against the Company, TiVo, Inc. and Blockbuster, Inc. in the United States District Court for the Eastern District of Virginia. The complaint alleges that the Company infringed U.S. Patents Nos. 5,867,799 and 5,983,214, entitled Information System and Method for Filtering a Massive Flow of Information Entities to Meet User Information Classification Needs and System and Method Employing Individual User Content-Based Data and User Collaboration Feedback Data to Evaluate the Content of an Information Entity in a Large Information Communication Network , respectively. The complaint seeks unspecified compensatory and enhanced damages, interest and fees, and seeks to permanently enjoin the defendants from infringing the patents in the future. On August 6, 2007, the case was transferred to the District of Massachusetts. On June 27, 2008, TiVo, Inc. was dismissed from the litigation pursuant to a stipulation with the plaintiff.

9. Related Party Transaction

In April 2007, Netflix entered into a license agreement with a company in which an employee had a significant ownership interest at that time. Pursuant to this agreement, Netflix recorded a charge of $2.5 million in technology and development expense in 2007. In January 2008, in conjunction with various arrangements, Netflix paid a total of $6.0 million to this same company, of which $5.7 million was accounted for as an investment under the cost method. The investment is included in other assets in the condensed consolidated balance sheet. In conjunction with these arrangements, the employee with the significant ownership interest in the same company terminated his employment with Netflix.

Item 2. **Management s Discussion and Analysis of Financial Condition and Results of Operations**

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the federal securities laws. These forward-looking statements include, but are not limited to, statements regarding: our strategy for delivering streaming content; subscriber growth; operating expenses; interest and other income (expense); liquidity; churn; developments in DVD formats; that the DVD format will continue to be the main vehicle for watching content in the home; the broadening of our distribution capabilities over other platforms; and average revenue per average paying subscriber. These forward-looking statements can be identified by words such as: will , anticipate , intend , may , expect and derivations thereof. These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission (SEC) on February 28, 2008, in the Quarterly Reports on Form 10-Q filed with the SEC on May 6, 2008 and August 11, 2008.

We assume no obligation to revise or publicly release any revision to any forward-looking statements contained in this Quarterly Report on Form 10-Q.

Table of Contents

Overview

Our Business

We are an online movie rental subscription service in the United States (U.S.), providing approximately 8.7 million subscribers access to over 100,000 DVD titles plus a growing library of over 12,000 choices that subscribers can watch on their PCs and TVs via Netflix ready devices (streaming content). We offer a variety of subscription plans with no due dates, no late fees and no shipping fees. Subscribers select titles at our Web site aided by our proprietary recommendation service, receive them on DVD by U.S. mail and return them to us at their convenience using our prepaid mailers. After a DVD has been returned, we mail the next available DVD in a subscriber s queue. We also offer certain movies and TV episodes that can be watched on subscribers PCs and TVs via Netflix ready devices. The terms and conditions by which subscribers utilize our service and a more detailed description of how our service works can be found at www.netflix.com/TermsOfUse.

Our core strategy is to grow a large DVD subscription business and expand into streaming content as that market develops. We believe that the DVD format, along with its high definition successor format, Blu-ray Disc, will continue to be the main vehicle for watching content in the home for the foreseeable future, and, by growing a large DVD subscription business, we will be well positioned to transition our subscribers and our business to stream movies and TV episodes if that becomes the preferred consumer medium for accessing content.

Key Business Metrics

Management periodically reviews certain key business metrics within the context of our articulated performance goals in order to evaluate the effectiveness of our operational strategies, allocate resources and maximize the financial performance of our business. The key business metrics include the following:

Churn: Churn is a monthly measure defined as customer cancellations in the quarter divided by the sum of beginning subscribers and gross subscriber additions, then divided by three months. Management reviews this metric to evaluate whether we are retaining our existing subscribers in accordance with our business plans.

Subscriber Acquisition Cost: Subscriber acquisition cost is defined as total marketing expense divided by total gross subscriber additions. Management reviews this metric to evaluate how effective our marketing programs are in acquiring new subscribers on an economical basis in the context of estimated subscriber lifetime value.

Gross Margin: Management reviews gross margin to monitor variable costs and operating efficiency.

Management believes it is useful to monitor these metrics together and not individually as management does not make business decisions based upon any single metric. Please see Results of Operations below for further discussion on these key business metrics.

Performance Highlights

The following represents our performance highlights for the three months ended September 30, 2008, June 30, 2008 and September 30, 2007 and the nine months ended September 30, 2008 and September 30, 2007:

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands except per share data, percentages and subscriber acquisition cost)							
Revenues	$ 341,269	$ 337,614	$ 293,972	16.1%	1.1%	$ 1,005,066	$ 902,985	11.3%
Net income	20,371	26,579	15,647	30.2%	(23.4%)	60,294	50,917	18.4%
Net income per share - diluted	$ 0.33	$ 0.42	$ 0.23	43.5%	(21.4%)	$ 0.95	$ 0.73	30.1%
	8,672	8,411	7,028	23.4%	3.1%	8,672	7,028	23.4%

Total subscribers at end of period									
Churn	4.2%	4.2%	4.2%						
Subscriber acquisition cost	$ 32.21	$ 28.89	$ 37.89	(15.0%)	11.5%	$ 30.18	$ 43.31	(30.3%)	
Gross margin	34.2%	31.8%	33.9%	0.9%	7.5%	32.6%	35.1%	(7.1%)	

Recent Developments and Initiatives

We continue to make progress in the area of streaming content. We have announced several partnerships with technology and consumer electronics companies that will enable our subscribers to stream content directly to their television sets. These partners include Roku, LG, Microsoft, Samsung, and TiVo. The Netflix Player by Roku as well as LG s BD300 Blu-ray player are currently

Table of Contents

available for retail purchase. We continue to increase our streaming content offering as well, including recent additions of content from CBS, Disney and Starz Play.

We believe that recent deterioration in the economy has slowed our growth. We would anticipate that a continued deterioration in the economy or a prolonged recession would slow the rate of subscriber growth or otherwise impact our business, including churn and subscriber acquisition costs.

Critical Accounting Policies and Estimates

There have been no significant changes during the nine months ended September 30, 2008 to the items that we disclosed as our critical accounting policies and estimates in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007.

Results of Operations

The following table sets forth, for the periods presented, the line items in our condensed consolidated statements of operations as a percentage of total revenues. The information contained in the table below should be read in conjunction with the condensed consolidated financial statements, notes to the condensed consolidated financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included in this Quarterly Report on Form 10-Q.

	Three Months Ended			Nine Months Ended	
	September 30, 2008	June 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues:					
Subscription	54.7%	57.4%	55.6%	56.5%	54.9%
Fulfillment expenses	11.1%	10.8%	10.5%	10.9%	10.0%
Total cost of revenues	65.8%	68.2%	66.1%	67.4%	64.9%
Gross margin	34.2%	31.8%	33.9%	32.6%	35.1%
Operating expenses:					
Technology and development	6.8%	6.6%	6.2%	6.5%	5.9%
Marketing	14.4%	11.8%	16.7%	14.3%	18.4%
General and administrative	3.4%	4.0%	4.4%	3.9%	4.3%
Gain on disposal of DVDs	(0.4%)	(0.7%)	(0.8%)	(0.4%)	(0.6%)
Gain on legal settlement					(0.8%)
Total operating expenses	24.2%	21.7%	26.5%	24.3%	27.2%
Operating income	10.0%	10.1%	7.4%	8.3%	7.9%
Other income (expense):					
Interest expense on lease financing obligations	(0.2%)	(0.2%)	(0.1%)	(0.2%)	(0.1%)
Interest and other income (expense)	0.4%	0.7%	1.7%	1.2%	1.7%
Income before income taxes	10.2%	10.6%	9.0%	9.3%	9.5%
Provision for income taxes	4.2%	2.7%	3.7%	3.3%	3.9%
Net income	6.0%	7.9%	5.3%	6.0%	5.6%

24

Table of Contents

Revenues

We currently generate all of our revenues in the United States. We derive substantially all of our revenues from monthly subscription fees and recognize subscription revenues ratably over each subscriber s monthly subscription period.

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands except percentages and average monthly revenue per paying subscriber)							
Revenues	$ 341,269	$ 337,614	$ 293,972	16.1%	1.1%	$ 1,005,066	$ 902,985	11.3%
Average number of paying subscribers	8,363	8,169	6,727	24.3%	2.4%	8,082	6,595	22.5%
Average monthly revenue per paying subscriber	$ 13.60	$ 13.78	$ 14.57	(6.7%)	(1.3%)	$ 13.82	$ 15.21	(9.1%)

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

The increase in our revenues during the three and nine months ended September 30, 2008 as compared to the same prior-year periods was primarily a result of the substantial growth in the average number of paying subscribers. This was partly offset by a price reduction for our most popular subscription plans during the second half of 2007 and a decline in the average monthly revenue per paying subscriber resulting from the continued growth of our lower cost subscription plans.

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The increase in our revenues during the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily a result of the growth in the average number of paying subscribers. This was partly offset by a one-time credit of $6.5 million given to subscribers related to a shipping disruption during the quarter.

Churn was flat at 4.2% in the third quarter of 2008, as compared with the second quarter of 2008 and the third quarter of 2007.

We anticipate that the average revenue per paying subscriber will continue to decline until the mix of new subscribers and existing subscribers is approximately equivalent by subscription plan price point.

The following table presents our ending subscriber information:

	As of		
	September 30, 2008	June 30, 2008	September 30, 2007
	(in thousands, except percentages)		
Free subscribers	182	176	183
As a percentage of total subscribers	2.1%	2.1%	2.6%
Paid subscribers	8,490	8,235	6,845
As a percentage of total subscribers	97.9%	97.9%	97.4%
Total subscribers	8,672	8,411	7,028

Cost of Revenues

Subscription

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07

	(in thousands, except percentages)							
Subscription	$ 186,573	$ 193,769	$ 163,707	14.0%	(3.7%)	$ 567,498	$ 495,734	14.5%
As a percentage of revenues	54.7%	57.4%	55.6%			56.5%	54.9%	

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

The increase in cost of subscription revenues for the three and nine months ended September 30, 2008 as compared to the same prior-year periods was primarily attributable to the following factors:

The number of DVDs mailed to paying subscribers increased 23% and 19%, respectively, in the three and nine months ended September 30, 2008, which was driven by an increase in the number of average paying subscribers of 24% and 23%, respectively. This increase was partially offset by a decline in monthly DVD rentals per average paying subscriber attributed to the continued popularity of our lower priced plans.

Table of Contents

Postage and packaging expenses increased by 25% and 24%, respectively, in the three and nine months ended September 30, 2008. This was primarily attributable to an increase in the number of DVDs mailed to paying subscribers and increases in the rates of first class postage in May 2007 and May 2008.

Revenue sharing expenses increased by 25% and 10%, respectively, in the three and nine months ended September 30, 2008. This increase was primarily attributable to an increase in the number of DVDs subject to revenue sharing agreements mailed to paying subscribers coupled with the increases in the number of average paying subscribers.

Content library amortization increased by 9% for the nine months ended September 30, 2008. This increase was primarily due to acquisitions in the content library. The content library amortization for the three months ended September 30, 2008 was relatively flat as compared to the same prior-period.

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The decrease in cost of subscription revenues for the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily attributable to the following factors:

Content library amortization decreased by 17%. This was primarily attributable to decreased content library acquisitions resulting from a decline in the purchase of new release DVDs.

Revenue sharing expenses decreased by 5%. This was primarily attributable to a decrease in the number of DVDs subject to revenue sharing agreements mailed to paying subscribers.

The number of DVDs mailed to paying subscribers increased by 2%. This increase was primarily attributed to the increase in the number of average paying subscribers.

Postage and packaging expenses increased by 3%. This increase was primarily attributable to the increase in the number of DVDs mailed to paying subscribers, as well as the increase in the rates of first class postage effective May 2008.

Fulfillment Expenses

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands, except percentages)							
Fulfillment expenses	$ 37,923	$ 36,318	$ 30,746	23.3%	4.4%	$ 109,890	$ 90,384	21.6%
As a percentage of revenues	11.1%	10.8%	10.5%			10.9%	10.0%	

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

The increase in fulfillment expenses for the three and nine months ended September 30, 2008 as compared to the same prior-year periods was primarily attributable to an increase in personnel-related costs resulting from the higher volume of activities in our shipping centers and customer service location, coupled with higher credit card fees as a result of the increase in revenues from subscriptions. In addition, the increase in fulfillment expenses was attributable to additional facility-related costs resulting from the addition of new shipping centers.

Table of Contents

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The increase in fulfillment expenses for the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily attributable to an increase in costs for customer service, as well as an increase in depreciation related to equipment used in our shipping centers. In addition, credit card fees increased resulting from the increase in revenues from subscriptions.

Gross Margin

	Three Months Ended			Nine Months Ended	
	September 30, 2008	June 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	(in thousands, except percentages)				
Gross profit	$ 116,773	$ 107,527	$ 99,519	$ 327,678	$ 316,867
Gross margin	34.2%	31.8%	33.9%	32.6%	35.1%

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

The increase in gross margin for the three months ended September 30, 2008 as compared to the same prior-year period was primarily attributable to a decrease in content spending as a percentage of revenue, partly offset by an increase in postage and packaging expenses as a result of the increase in postage rates effective in May 2008.

The decrease in gross margin for the nine months ended September 30, 2008 as compared to the same prior-year period was primarily attributable to a reduction in the prices of our most popular subscription plans during the second half of 2007 and increases in postage rates effective May 2007 and May 2008.

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The increase in gross margin for the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily attributable to a decrease in content spending as a percentage of revenue, driven by a weak new release calendar. This was partly offset by an increase in postage and packaging expenses resulting from the increase in postage rates effective in May 2008.

Table of Contents

Technology and Development

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands, except percentages)							
Technology and development	$ 23,368	$ 22,186	$ 18,112	29.0%	5.3%	$ 65,821	$ 52,526	25.3%
As a percentage of revenues	6.8%	6.6%	6.2%			6.5%	5.9%	

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

The increase in technology and development expenses for the three and nine months ended September 30, 2008 as compared to the same prior-year periods was primarily attributable to an increase in personnel-related costs due to growth in headcount.

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The increase in technology and development expenses during the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily attributable to an increase in personnel-related costs.

We regularly research and test a variety of potential improvements to our internal hardware and software systems in an effort to improve our productivity and enhance our subscribers experiences. As a result, we anticipate that our technology and development expenses will increase on a year-over-year basis for the remainder of 2008.

Marketing

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands, except percentages and subscriber acquisition cost)							
Marketing	$ 49,217	$ 39,984	$ 49,149	0.1%	23.1%	$ 144,096	$ 166,508	(13.5%)
As a percentage of revenues	14.4%	11.8%	16.7%			14.3%	18.4%	
Other data:								
Gross subscriber additions	1,528	1,384	1,297	17.8%	10.4%	4,774	3,845	24.2%
Subscriber acquisition cost	$ 32.21	$ 28.89	$ 37.89	(15.0%)	11.5%	$ 30.18	$ 43.31	(30.3%)

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

Marketing expenses for the three months ended September 30, 2008 as compared to the same prior-year period was relatively flat. The decrease in marketing expenses for the nine months ended September 30, 2008 as compared to the same prior-year period was primarily attributable to a decrease in marketing program spending, primarily in direct mail advertising.

Subscriber acquisition cost decreased for the three and nine months ended September 30, 2008 as compared to the same prior-year periods primarily due to changes in the competitive environment coupled with a decrease in marketing spending to offset, in part, the costs of the price decrease we implemented in the second half of 2007.

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The increase in marketing expenses during the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily attributable to an increase in marketing program spending, primarily in online advertising, direct mail advertising and inserts.

Subscriber acquisition cost increased for the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 primarily due to a decline in acquisition rates across all channels.

We anticipate that marketing expenses will decrease on a year-over-year basis as we reduce marketing spending to offset, in part, the costs of the price decrease we implemented in the second half of 2007.

Table of Contents

General and Administrative

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands, except percentages)							
General and administrative	$ 11,742	$ 13,419	$ 12,863	(8.7%)	(12.5%)	$ 38,900	$ 38,834	0.2%
As a percentage of revenues	3.4%	4.0%	4.4%			3.9%	4.3%	

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

The decrease in general and administrative expenses for the three months ended September 30, 2008 as compared to the same prior-year period was primarily attributable to a decrease in personnel-related costs.

General and administrative expenses for the nine months ended September 30, 2008 as compared to the same prior-year period was relatively flat.

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The decrease in general and administrative expenses during the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily attributable to a decrease in personnel-related costs.

We anticipate that general and administrative expenses will decrease on a year-over-year basis for the remainder of 2008 due to lower personnel-related costs.

Gain on Legal Settlement

On June 25, 2007, we resolved a pending patent litigation with Blockbuster, Inc. As part of the settlement, we received a one-time payment of $7.0 million during the second quarter of 2007.

Interest Expense on Lease Financing Obligations

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands, except percentages)							
Interest expense on lease financing obligations	$ (677)	$ (681)	$ (296)	128.7%	(0.6%)	$ (1,781)	$ (893)	99.4%
As a percentage of revenues	(0.2)%	(0.2)%	(0.1)%			(0.2)%	(0.1)%	

In June 2004 and June 2006, we entered into two separate lease arrangements whereby we leased a building that was constructed by a third party. As discussed in Note 2 of the condensed consolidated financial statements, we have accounted for these leases in accordance with EITF No. 97-10, *The Effect of Lessee Involvement in Asset Construction*, and SFAS No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases; an amendment of FASB Statements No. 13, 66, and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11*, which causes Netflix to be considered the owner (for accounting purposes) of the two buildings.

Accordingly, we have recorded assets on our balance sheet for the costs paid by our lessor to construct our headquarters facilities, along with corresponding financing liabilities for amounts equal to these lessor-paid construction costs. The monthly rent payments we make to our lessor under our lease agreements are recorded in our financial statements as land lease expense and principal and interest on the financing liabilities. Interest expense on lease financing obligations reflects the portion of our monthly lease payments that is allocated to interest expense.

29

Table of Contents

Interest and Other Income (Expense)

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2008	June 30, 2008	September 30, 2007	Q3 08 vs. Q3 07	Q3 08 vs Q2 08	September 30, 2008	September 30, 2007	Q3 08 vs. Q3 07
	(in thousands, except percentages)							
Interest and other income (expense)	$ 1,536	$ 2,404	$ 5,089	(69.8%)	(36.1%)	$ 11,600	$ 15,411	(24.7%)
As a percentage of revenues	0.4%	0.7%	1.7%			1.2%	1.7%	

Three and nine months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007

The decrease in interest and other income (expense) for the three and nine months ended September 30, 2008 as compared with the same prior-year periods was primarily attributable to a lower cash balance resulting from the repurchase of our common stock.

Three months ended September 30, 2008 as compared to the three months ended June 30, 2008

The decrease in interest and other income (expense) during the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 was primarily attributable to a lower cash balance resulting from the repurchase of our common stock coupled with a lower yield during the third quarter of 2008.

For the remainder of 2008, we anticipate that interest and other income (expense) will consist primarily of interest income.

Income Taxes

	Three Months Ended			Nine Months Ended	
	September 30, 2008	June 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	(in thousands, except percentages)				
Income taxes	$ 14,562	$ 9,345	$ 10,851	$ 33,110	$ 35,100
Effective tax rate	41.7%	26.0%	41.0%	35.4%	40.8%

The effective tax rate for the three months ended September 30, 2008 was 41.7%. The provision is primarily for the U.S. federal and state taxes netted with the research and development credits claimed during the year. Our effective tax rate differed from the federal statutory rate primarily due to state tax provision netted with the research and development credits claimed. Our effective tax rate for the three months ended September 30, 2008 as compared to the same prior-year period was relatively flat. The decrease in our effective tax rates for the nine months ended June 30, 2008 as compared to the same prior-year period was primarily attributable to the impact of federal and state tax credits recorded during the year.

Due to our taxable loss position in prior years, all tax years are open to examination in the U.S and state jurisdictions. We are also open to examination in various state jurisdictions for tax years 2000 and forward, none of which were individually material. We do not anticipate the total amount of its unrecognized tax benefits to significantly change over the next twelve months.

Liquidity and Capital Resources

As of September 30, 2008, we had cash and cash equivalents of $111.5 million and short-term investments of $139.3 million, for a combined total of $250.8 million. Short-term investments are comprised of corporate debt securities, government and agency securities and asset and mortgage-backed securities. Substantially all of the residential and commercial mortgage-backed securities are AAA rated. The mortgage bonds owned represent the senior tranches of the capital structure and provide credit enhancement through over-collateralization and their subordinated characteristics.

We have generated net cash from operations during each quarter since the second quarter of 2001. Many factors will impact our ability to continue to generate and grow cash from our operations including, but not limited to, the number of subscribers who sign up for our service and the growth or reduction in our subscriber base. In addition, we may have or otherwise choose to lower our prices and increase our marketing

expenses in order to grow faster or respond to competition. Although we currently anticipate that cash flows from operations, together with our available funds, will be sufficient to meet our cash needs for the foreseeable future, we may require or choose to obtain additional financing. Our ability to obtain financing will depend on, among other things, our development efforts, business plans, operating performance and the condition of the capital markets at the time we seek financing.

Our primary source of liquidity has been cash from operations, which consists mainly of net income adjusted for non-cash items such as amortization of our content library, the depreciation of property and equipment, and stock-based compensation related to the

Table of Contents

issuance of common stock. Our primary uses of cash include our stock repurchase programs, the acquisition of content, marketing expenses and fulfillment expenses. The following table highlights selected measures of our liquidity and capital resources for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
	(in thousands)			
Net cash provided by operating activities	$ 73,231	$ 77,663	$ 229,245	$ 206,021
Net cash used in investing activities	(19,403)	(52,197)	(124,770)	(385,937)
Net cash used in financing activities	(86,593)	(29,844)	(170,390)	(40,710)

Operating Activities

During the three months ended September 30, 2008, our operating activities consisted of net income of $20.4 million, increased by non-cash adjustments of $51.7 million, and an increase in net operating assets and liabilities of $1.1 million. The majority of the non-cash adjustments resulted from $47.6 million of amortization of the content library. Cash provided by operating activities decreased $4.4 million for the three months ended September 30, 2008 as compared to the same prior-year period. This was primarily due to a decrease in net operating assets and liabilities, offset by an increase in net income and non-cash adjustments.

During the nine months ended September 30, 2008, our operating activities consisted of net income of $60.3 million, increased by non-cash adjustments of $169.8 million, and a decrease in net operating assets and liabilities of $0.9 million. The majority of the non-cash adjustments resulted from $162.2 million of amortization of the content library. Our content library increased as we continued to both purchase and license additional content in order to support our larger subscriber base. Cash provided by operating activities increased $23.2 million for the nine months ended September 30, 2008 as compared to the same prior-year period. This was primarily due to a decrease in net operating assets and liabilities, offset by an increase in net income and non-cash adjustments.

Investing Activities

During the three months ended September 30, 2008, our investing activities consisted primarily of acquisitions of content, purchases and sales of available-for-sale securities and purchases of property and equipment. Cash used in investing activities decreased $32.8 million for the three months ended September 30, 2008 as compared to the same prior-year period. This is primarily attributable to a decrease of $29.0 million in purchases of available-for-sale securities coupled with an increase of $9.3 million in the proceeds from the sales of available-for-sale securities.

During the nine months ended September 30, 2008, our investing activities consisted primarily of purchases and sales of available-for-sale securities, acquisitions of content and purchases of property and equipment. Cash used in investing activities decreased $261.2 million for the nine months ended September 30, 2008 as compared to the same prior-year period. This is primarily attributable to a decrease of $189.3 million in purchases of available-for-sale securities coupled with an increase of $82.2 million in the proceeds from the sales of available-for-sale securities as compared to the same prior-year period.

Financing Activities

During the three months ended September 30, 2008, our financing activities consisted primarily of repurchases of common stock. Cash used in financing activities increased $56.7 million during the three months ended September 30, 2008 as compared to the same prior-year period primarily due to an increase in stock repurchases of $54.7 million.

During the nine months ended September 30, 2008, our financing activities consisted primarily of repurchases of common stock. Cash used in financing activities increased by $129.7 million during the nine months ended September 30, 2008 as compared to the same prior-year period primarily due to an increase in stock repurchases of $124.4 million. On April 17, 2007, our Board of Directors authorized a stock repurchase program allowing us to repurchase up to $100 million of our common stock through the end of 2007. Under this program, we repurchased 4,733,788 shares of common stock at an average price of approximately $21 per share for an aggregate amount of $100 million. On January 31, 2008, our Board of Directors authorized a stock repurchase program allowing us to repurchase up to $100 million of our common stock through the end of 2008. Under this program, we repurchased 3,847,062 shares of common stock at an average price of approximately $26 per share for an aggregate amount of approximately $100 million. On March 5, 2008, our Board of Directors authorized a stock repurchase program allowing us to repurchase up to $150 million of our common stock through the end of 2008. Under this program, we repurchased 2,991,684 shares of

common stock at an average price of approximately $30 per share for an aggregate amount of $90 million during the nine months ended September 30, 2008.

Table of Contents

Contractual Obligations

Contractual obligations for purchases of goods or services are defined as agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The expected timing of payment of the obligations discussed above is estimated based on the information available to us as of September 30, 2008. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services or changes to agreed-upon amounts for some obligations. The following table summarizes our contractual obligations at September 30, 2008:

	Payments due by Period				
Contractual obligations (in thousands):	**Total**	**Less than 1 year**	**1-3 Years**	**3-5 Years**	**More than 5 years**
Operating lease obligations	$ 25,754	$ 10,681	$ 11,777	$ 2,857	$ 439
Lease financing obligations (1)	25,265	5,473	11,544	8,248	
Other purchase obligations (2)	149,145	78,999	59,293	10,853	
Total	$ 200,164	$ 95,153	$ 82,614	$ 21,958	$ 439

(1) See Note 2 to the condensed consolidated financial statements for further discussion.

(2) Other purchase obligations relate primarily to acquisitions for our content library.

License Agreements

In addition to the above contractual obligations, we have certain license agreements with studios that include a maximum number of titles that we may or may not receive in the future. Access to these titles is based on the discretion of the studios and, as such, we may not receive these titles. If we did receive access to the maximum number of titles, we would incur up to an additional $25.4 million in commitments.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not engage in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities. Accordingly, our operating results, financial condition and cash flows are not subject to off-balance sheet risks.

Operating Leases

We have entered into various non-cancelable operating lease agreements for our offices and distribution centers throughout the U.S. with original lease periods expiring through 2013. Certain of these leases have free or escalating rent payment provisions. We recognize rent expense on our operating leases on a straight-line basis at the commencement of the lease.

In June 2004, we entered into a seven year lease arrangement for our headquarters in Los Gatos, California. In March 2006, we exercised our option to lease over five years an adjacent building. The buildings were completed in the first quarter of 2006 and 2008, respectively, and each building comprises approximately 80,000 square feet of office space. The terms of the lease agreements required our involvement in the construction of certain elements of the buildings. Upon commencement of the lease, we accounted for both of these arrangements as operating leases, whereby the total minimum lease payment obligations under the leases were recognized as monthly rent expense on a straight-line basis over the term of the lease. In June 2008, we concluded that GAAP requires these leases to be treated as financing obligations, and accordingly have corrected our historical accounting. As we are deemed to be the owner (for accounting purposes only) of the buildings subject to the leases during the construction period, we have recorded an asset as well as a corresponding liability for the costs paid by the lessor to construct these buildings. The corrections were deemed immaterial to our financial statements and did not affect the total cash payments we have made or our payment obligations under the lease agreements. See Note 2 to the condensed consolidated financial statements for further discussion.

Indemnifications

In the ordinary course of business, we enter into contractual arrangements under which we agree to provide indemnification of varying scope and terms to business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of our breach of such agreements and out of intellectual property infringement claims made by third parties. In these circumstances, payment may be conditional on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow us to challenge the other party s claims. Further, our obligations under these agreements may be limited in terms of time and/or amount, and, in some instances, we may have recourse against third parties for certain payments made by us under these agreements. In addition, we have entered into indemnification agreements with our directors and

Table of Contents

certain of our officers that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers or in other capacities in which we ask them to serve. The terms of such obligations vary.

It is not possible to make a reasonable estimate of the maximum potential amount of future payments under these or similar agreements due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. No amount has been accrued in the accompanying condensed consolidated financial statements with respect to these indemnification obligations.

Recent Accounting Pronouncements

In May 2008, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 162, *The Hierarchy of Generally Accepted Accounting Principles.* SFAS No. 162 identifies the sources of accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS 162 is effective 60 days following the Securities and Exchange Commission approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles* . We currently adhere to the hierarchy of GAAP as presented in SFAS No. 162, and do not expect the adoption of this standard to have a material impact on our financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, to replace SFAS No. 141, *Business Combinations*. SFAS No. 141(R) requires the use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and broadens the scope to all transactions and other events in which one entity obtains control over one or more other businesses. This statement is effective for financial statements issued for fiscal years beginning on or after December 15, 2008. We do not expect the adoption of this standard to have a material impact on our financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 allows companies to choose to measure many financial instruments and certain other items at fair value. The statement requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 also amends certain provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. SFAS No. 159 was effective for us beginning in the first quarter of fiscal 2008. We elected to account for the investment in a business under the cost method during the first quarter of 2008. The adoption of SFAS No. 159 in the first quarter of fiscal 2008 did not impact our financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2, which delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for items within the scope of FSP No. 157-2. Effective January 1, 2008, we adopted SFAS No. 157 for financial assets and liabilities recognized at fair value on a recurring basis. The partial adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on our financial position or results of operations. In October 2008, the FASB issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. FSP No. 157-3 clarifies the application of SFAS No. 157 in cases where a market is not active. We have considered FSP No. 157-3 in our determination of estimated fair values as of September 30, 2008 and the impact was not material. See Note 3 to the condensed consolidated financial statements for further discussion.

Item 3. **Quantitative and Qualitative Disclosures About Market Risk**

For financial market risks related to changes in interest rates, reference is made to Item 7A Quantitative and Qualitative Disclosures About Market Risk contained in Part II of our Annual Report on Form 10-K for the year ended December 31, 2007. We started an investment portfolio during the first quarter of 2007 which is comprised of corporate debt securities, government and agency securities and asset and mortgage-backed securities. However, our exposure to market risk has not changed significantly since December 31, 2007.

Item 4. **Controls and Procedures**

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as

Table of Contents

amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q were effective in providing reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Netflix have been detected.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. **Legal Proceedings**

The information set forth under Note 8 in the notes to the condensed consolidated financial statements is incorporated herein by reference.

Item 1A. **Risk Factors**

There have been no material changes from risk factors as previously disclosed under the heading Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

Item 2. **Unregistered Sales of Equity Securities and Use of Proceeds**

Stock repurchases during the three months ended September 30, 2008 were as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Dollar Value that May Yet Be Purchased Under the Program (1)
July 1, 2008 - July 31, 2008	439,000	$ 28.49	439,000	$ 137,491,793
August 1, 2008 - August 31, 2008	2,214,457	30.33	2,214,457	70,330,619
September 1, 2008 - September 30, 2008	338,227	30.63	338,227	59,971,923
Total	2,991,684	$ 30.09	2,991,684	$

(1) On March 5, 2008, the Company s Board of Directors authorized a stock repurchase program allowing the Company to repurchase up to $150.0 million of its common stock through the end of 2008. For further information regarding stock repurchase activity, see Note 6 of Notes to Condensed Consolidated Financial Statements in this Quarterly Report.

Table of Contents

Item 6. **Exhibits**

(a) Exhibits:

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation	10-Q	000-49802	3.1	August 2, 2004	
3.2	Amended and Restated Bylaws	S-1/A	333-83878	3.4	April 16, 2002	
3.3	Certificate of Amendment to the Amended and Restated Certificate of Incorporation	10-Q	000-49802	3.3	August 2, 2004	
4.1	Form of Common Stock Certificate	S-1/A	333-83878	4.1	April 16, 2002	
10.1	Form of Indemnification Agreement entered into by the registrant with each of its executive officers and directors	S-1/A	333-83878	10.1	March 20, 2002	
10.2	2002 Employee Stock Purchase Plan	10-Q	000-49802	10.16	August 9, 2006	
10.3	Amended and Restated 1997 Stock Plan	S-1/A	333-83878	10.3	May 16, 2002	
10.4	Amended and Restated 2002 Stock Plan	Def 14A	000-49802	A	March 31, 2006	
10.5	Amended and Restated Stockholders Rights Agreement	S-1	333-83878	10.5	March 6, 2002	
10.6	Lease between Sobrato Land Holdings and Netflix, Inc.	10-Q	000-49802	10.15	August 2, 2004	
10.7	Lease between Sobrato Interests II and Netflix, Inc.	10-Q	000-49802	10.16	August 2, 2004	
10.8	Lease between Sobrato Land Holdings and Netflix, Inc. dated June 26, 2006	10-Q	000-49802	10.16	August 9, 2006	
10.9	Description of Director Equity Compensation Plan	8-K	000-49802	10.1	July 5, 2005	
10.10	Executive Severance and Retention Incentive Plan	8-K	000-49802	10.2	July 5, 2005	
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes -Oxley Act of 2002					X

* These certifications are not deemed filed by the SEC and are not to be incorporated by reference in any filing we make under the Securities Act of 1933 or the Securities Exchange Act of 1934, irrespective of any general incorporation language in any filings.

Indicates a management contract or compensatory plan.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NETFLIX, INC.

Dated: November 3, 2008	By:	/s/ REED HASTINGS **Reed Hastings** **Chief Executive Officer** ***(Principal executive officer)***
Dated: November 3, 2008	By:	/s/ BARRY MCCARTHY **Barry McCarthy** **Chief Financial Officer** ***(Principal financial and accounting officer)***

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation	10-Q	000-49802	3.1	August 2, 2004	
3.2	Amended and Restated Bylaws	S-1/A	333-83878	3.4	April 16, 2002	
3.3	Certificate of Amendment to the Amended and Restated Certificate of Incorporation	10-Q	000-49802	3.3	August 2, 2004	
4.1	Form of Common Stock Certificate	S-1/A	333-83878	4.1	April 16, 2002	
10.1	Form of Indemnification Agreement entered into by the registrant with each of its executive officers and directors	S-1/A	333-83878	10.1	March 20, 2002	
10.2	2002 Employee Stock Purchase Plan	10-Q	000-49802	10.16	August 9, 2006	
10.3	Amended and Restated 1997 Stock Plan	S-1/A	333-83878	10.3	May 16, 2002	
10.4	Amended and Restated 2002 Stock Plan	Def 14A	000-49802	A	March 31, 2006	
10.5	Amended and Restated Stockholders Rights Agreement	S-1	333-83878	10.5	March 6, 2002	
10.6	Lease between Sobrato Land Holdings and Netflix, Inc.	10-Q	000-49802	10.15	August 2, 2004	
10.7	Lease between Sobrato Interests II and Netflix, Inc.	10-Q	000-49802	10.16	August 2, 2004	
10.8	Lease between Sobrato Land Holdings and Netflix, Inc. dated June 26, 2006	10-Q	000-49802	10.16	August 9, 2006	
10.9	Description of Director Equity Compensation Plan	8-K	000-49802	10.1	July 5, 2005	
10.10	Executive Severance and Retention Incentive Plan	8-K	000-49802	10.2	July 5, 2005	
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes -Oxley Act of 2002					X

* These certifications are not deemed filed by the SEC and are not to be incorporated by reference in any filing we make under the Securities Act of 1933 or the Securities Exchange Act of 1934, irrespective of any general incorporation language in any filings.

Indicates a management contract or compensatory plan.

38