NETFLIX INC
Form 10-Q
July 17, 2015
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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 June 30, 2015
OR

o 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: 001-35727

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 o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
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	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes o No x
As of June 30, 2015, there were 426,004,831 shares of the registrant's common stock, par value $0.001, outstanding.

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NETFLIX, INC.
Consolidated Statements of Operations
(unaudited)
(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Revenues	$1,644,694	$1,340,407	$3,217,823	$2,610,496
Cost of revenues	1,121,752	914,848	2,168,153	1,784,034
Marketing	197,140	120,763	391,817	257,861
Technology and development	155,061	115,182	298,167	225,492
General and administrative	95,906	60,014	187,395	115,914
Operating income	74,835	129,600	172,291	227,195
Other income (expense):				
Interest expense	(35,217)	(13,328)	(61,954)	(23,380)
Interest and other income (expense)	872	1,100	(31,421)	2,501
Income before income taxes	40,490	117,372	78,916	206,316
Provision for income taxes	14,155	46,354	28,885	82,183
Net income	$26,335	$71,018	$50,031	$124,133
Earnings per share:				
Basic	$0.06	$0.17	$0.12	$0.30
Diluted	$0.06	$0.16	$0.12	$0.29
Weighted-average common shares outstanding:				
Basic	425,340	419,974	424,486	419,349
Diluted	436,097	431,441	434,958	431,141

See accompanying notes to the consolidated financial statements.

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NETFLIX, INC.
Consolidated Statements of Comprehensive Income
(unaudited)
(in thousands)

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Net income	$26,335	$71,018	$50,031	$124,133
Other comprehensive income (loss):				
Foreign currency translation adjustments	5,560	1,918	(33,930)	2,379
Change in unrealized gains on available-for-sale securities, net of tax of $25, $51, $158 and $342, respectively	(526)	81	256	548
Total other comprehensive (loss) income	5,034	1,999	(33,674)	2,927
Comprehensive income	$31,369	$73,017	$16,357	$127,060

See accompanying notes to the consolidated financial statements.

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NETFLIX, INC.

Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Cash flows from operating activities:				
Net income	$26,335	$71,018	$50,031	$124,133
Adjustments to reconcile net income to net cash (used in) provided by operating activities:				
Additions to streaming content library	(1,273,677)	(813,314)	(2,885,602)	(1,562,713)
Change in streaming content liabilities	191,154	78,359	817,479	120,603
Amortization of streaming content library	822,600	639,037	1,572,118	1,239,772
Amortization of DVD content library	20,813	16,923	41,998	33,044
Depreciation and amortization of property, equipment and intangibles	15,581	12,977	30,748	25,359
Stock-based compensation expense	28,590	29,285	56,031	55,110
Excess tax benefits from stock-based compensation	(39,427)	(14,628)	(68,428)	(47,360)
Other non-cash items	6,682	3,251	12,988	5,447
Deferred taxes	(4,232)	(16,569)	(41,274)	(29,672)
Changes in operating assets and liabilities:				
Other current assets	(39,614)	(20,685)	(16,505)	14,381
Accounts payable	6,447	(3,086)	(4,178)	19,726
Accrued expenses	41,624	59,008	77,546	58,566
Deferred revenue	16,414	11,315	27,168	25,563
Other non-current assets and liabilities	(633)	3,133	21,155	10,424
Net cash (used in) provided by operating activities	(181,343)	56,024	(308,725)	92,383
Cash flows from investing activities:				
Acquisition of DVD content library	(19,786)	(20,981)	(42,692)	(35,895)
Purchases of property and equipment	(27,538)	(19,869)	(40,574)	(33,203)
Other assets	(639)	1,129	(414)	1,424
Purchases of short-term investments	(67,949)	(170,908)	(158,889)	(231,454)
Proceeds from sale of short-term investments	48,412	89,662	100,360	232,710
Proceeds from maturities of short-term investments	19,170	92,014	51,057	95,104
Net cash (used in) provided by investing activities	(48,330)	(28,953)	(91,152)	28,686
Cash flows from financing activities:				
Proceeds from issuance of common stock	23,804	14,469	34,720	46,917
Proceeds from issuance of debt	—	—	1,500,000	400,000
Issuance costs	(397)	(353)	(17,629)	(7,080)
Excess tax benefits from stock-based compensation	39,427	14,628	68,428	47,360
Principal payments of lease financing obligations	(287)	(271)	(538)	(538)
Net cash provided by financing activities	62,547	28,473	1,584,981	486,659
Effect of exchange rate changes on cash and cash equivalents	6,221	1,250	(4,840)	1,551
Net (decrease) increase in cash and cash equivalents	(160,905)	56,794	1,180,264	609,279
Cash and cash equivalents, beginning of period	2,454,777	1,157,450	1,113,608	604,965
Cash and cash equivalents, end of period	$2,293,872	$1,214,244	$2,293,872	$1,214,244
Supplemental disclosure of non-cash investing activities:				

Increase in accounts payable related to purchases of property and equipment	$13,713	$5,528	$12,152	$5,792

See accompanying notes to the consolidated financial statements.

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NETFLIX, INC.
Consolidated Balance Sheets
(in thousands, except share and par value data)

	As of June 30, 2015 (unaudited)	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$2,293,872	$1,113,608
Short-term investments	502,886	494,888
Current content library, net	2,510,946	2,125,702
Other current assets	292,806	206,271
Total current assets	5,600,510	3,940,469
Non-current content library, net	3,640,767	2,773,326
Property and equipment, net	171,396	149,875
Other non-current assets	242,188	192,981
Total assets	$9,654,861	$7,056,651
Liabilities and Stockholders' Equity		
Current liabilities:		
Current content liabilities	$2,556,180	$2,117,241
Accounts payable	211,729	201,581
Accrued expenses	150,406	69,746
Deferred revenue	301,754	274,586
Total current liabilities	3,220,069	2,663,154
Non-current content liabilities	1,942,624	1,575,832
Long-term debt	2,400,000	900,000
Other non-current liabilities	60,093	59,957
Total liabilities	7,622,786	5,198,943
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock, $0.001 par value; 4,990,000,000 and 160,000,000 shares authorized at June 30, 2015 and December 31, 2014, respectively; 426,004,831 and 422,910,887 issued and outstanding at June 30, 2015 and December 31, 2014, respectively	1,200,880	1,042,870
Accumulated other comprehensive loss	(38,120)	(4,446)
Retained earnings	869,315	819,284
Total stockholders' equity	2,032,075	1,857,708
Total liabilities and stockholders' equity	$9,654,861	$7,056,651

See accompanying notes to the consolidated financial statements.

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NETFLIX, INC.
Notes to Consolidated Financial Statements
(unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying consolidated interim financial statements of Netflix, Inc. and its wholly owned subsidiaries (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, 2014 filed with the Securities and Exchange Commission (the “SEC”) on January 29, 2015.

The preparation of 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 consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include the streaming content library amortization policy; the recognition and measurement of income tax assets and liabilities; and the valuation of stock-based compensation. The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances. On a regular basis, the Company evaluates the assumptions, judgments and estimates. Actual results may differ from these 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, 2014. Interim results are not necessarily indicative of the results for a full year.

The Company has three reportable segments: Domestic streaming, International streaming and Domestic DVD. The majority of the Company’s revenues are generated in the United States, and substantially all of the Company’s long-lived tangible assets are held in the United States. The Company’s revenues are derived from monthly membership fees.

There have been no material changes in the Company’s significant accounting policies as compared to the significant accounting policies described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

Prior to January 1, 2015, the functional currency of certain of the Company's European entities was the British pound. The Company changed the functional currency of these entities to the euro effective January 1, 2015 following the redomiciliation of the European headquarters and the launch of the Netflix service in several significant European countries. The change in functional currency was applied prospectively from January 1, 2015. Monetary assets and liabilities have been remeasured to the euro at current exchange rates. Non-monetary assets and liabilities have been remeasured to the euro using the exchange rate effective for the period in which the balance arose. As a result of this change of functional currency, the Company recorded a $21.8 million cumulative translation adjustment included in other comprehensive loss for the six months ended June 30, 2015.

On July 14, 2015, the Company completed a seven-for-one stock split in the form of a stock dividend. References made to outstanding shares or per share amounts in the accompanying consolidated financial statements and applicable disclosures have been retroactively adjusted to reflect this seven-for-one stock split. The number of authorized shares as reflected on the Consolidated Balance Sheet were not affected by the stock split and accordingly have not been adjusted. See Notes 2 and 6 for additional information.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) which amended the existing accounting standards for revenue recognition. ASU 2014-09 establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. In July 2015, the FASB deferred the effective date for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods). Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently in the process of evaluating the impact of adoption of the

ASU on its consolidated financial statements, but does not expect the impact to be material.

In April 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs which changes the presentation of debt issuance costs in financial statements. ASU 2015-03 requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. It is effective for annual reporting periods beginning after December 15, 2015. Early adoption is permitted. The Company will adopt ASU 2015-03 on January 1, 2016, at which time the Company will reclassify approximately $30 million of debt issuance costs associated with the Company's long-term debt from other noncurrent assets to long-term debt. A reclassification will also be applied retrospectively to each prior period presented.

In April 2015, the FASB issued ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If the arrangement does not include a software license, the customer should account for a cloud computing arrangement as a service contract. It is effective for annual periods beginning after December 15, 2015. Early adoption is permitted. The amendment may be

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adopted either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. The Company has elected to early adopt the ASU in the third quarter of 2015 and will apply the guidance prospectively to all future arrangements. The Company does not expect the impact of the adoption of the ASU to be material to its consolidated financial statements.

2. Earnings Per Share

In June 2015, the Company's Board of Directors declared a seven-for-one stock split in the form of a stock dividend that was paid on July 14, 2015 to all shareholders of record as of July 2, 2015 ("Stock Split").

Outstanding share and per-share amounts disclosed as of June 30, 2015 and for all other comparative periods provided have been retroactively adjusted to reflect the effects of the Stock Split.

Basic earnings per share is computed using the weighted-average number of outstanding shares of common stock during the period. Diluted earnings 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 of incremental shares issuable upon the assumed exercise of stock options. The computation of earnings per share, as adjusted to reflect the effects of the Stock Split, are as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
	(in thousands, except per share data)			
Basic earnings per share:				
Net income	$26,335	$71,018	$50,031	$124,133
Shares used in computation:				
Weighted-average common shares outstanding	425,340	419,974	424,486	419,349
Basic earnings per share	$0.06	$0.17	$0.12	$0.30
Diluted earnings per share:				
Net income	$26,335	$71,018	$50,031	$124,133
Shares used in computation:				
Weighted-average common shares outstanding	425,340	419,974	424,486	419,349
Employee stock options	10,757	11,467	10,472	11,792
Weighted-average number of shares	436,097	431,441	434,958	431,141
Diluted earnings per share	$0.06	$0.16	$0.12	$0.29

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, as adjusted to reflect the effects of the Stock Split:

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
	(in thousands)			
Employee stock options	80	693	938	490

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3. Short-term Investments

The Company’s investment policy is consistent with the definition of available-for-sale securities. The Company does not buy and hold securities principally for the purpose of selling them in the near future. The Company’s policy is focused on preservation of capital, liquidity and return. From time to time, the Company may sell certain securities but the objectives are generally not to generate profits on short-term differences in price. The following tables summarize, by major security type, the Company’s assets that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy and where they are classified on the Consolidated Balance Sheets:

	As of June 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash	$2,193,203	$—	$—	$2,193,203
Level 1 securities:				
Money market funds	105,603	—	—	105,603
Level 2 securities:				
Corporate debt securities	271,569	419	(130)	271,858
Government securities	197,919	364	(7)	198,276
Certificate of deposits and commercial paper	6,100	—	—	6,100
Agency securities	26,621	31	—	26,652
Total	$2,801,015	$814	$(137)	$2,801,692

	As of December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash	$1,007,543	$—	$—	$1,007,543
Level 1 securities:				
Money market funds	111,759	—	—	111,759
Level 2 securities:				
Corporate debt securities	295,500	432	(199)	295,733
Government securities	168,749	120	(95)	168,774
Asset and mortgage-backed securities	112	—	—	112
Certificate of deposits	3,600	—	—	3,600
Agency securities	26,665	5	(1)	26,669
Total	$1,613,928	$557	$(295)	$1,614,190

	As of	
	June 30, 2015	December 31, 2014
	(in thousands)	
Cash and cash equivalents	$2,293,872	$1,113,608
Short-term investments	502,886	494,888
Other non-current assets (1)	4,934	5,694
Total	$2,801,692	$1,614,190

(1) Primarily restricted cash that is related to workers compensation deposits.

Fair value is a market-based measurement that is determined based on the assumptions that market participants would use in pricing an asset or liability. 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 fair value of available-for-sale securities and cash equivalents included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. The fair value of available-for-sale securities included in the Level 2 category is based on observable inputs, such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are

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observable, either directly or indirectly. These values were obtained from an independent pricing service and 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 Company's procedures include controls to ensure that appropriate fair values are recorded, such as comparing prices obtained from multiple independent sources. See Note 5 to the consolidated financial statements for further information regarding the fair value of the Company’s debt instruments.

There were no investments in a material unrealized loss position as of June 30, 2015 or December 31, 2014. There were no material other-than-temporary impairments or credit losses related to available-for-sale securities in the three or six months ended June 30, 2015 and 2014. In addition, there were no material gross realized gains or losses in the three or six months ended June 30, 2015 and 2014.
The estimated fair value of short-term investments by contractual maturity as of June 30, 2015 is as follows:

	(in thousands)
Due within one year	$ 172,268
Due after one year and through five years	330,618
Total short-term investments	$ 502,886

4. Balance Sheet Components
Content Library
Content library consisted of the following:

	As of June 30, 2015	December 31, 2014
	(in thousands)	
Total content library, gross	$10,253,672	$ 8,497,403
Accumulated amortization	(4,101,959)	(3,598,375)
Total content library, net	6,151,713	4,899,028
Current content library, net	2,510,946	2,125,702
Non-current content library, net	$3,640,767	$ 2,773,326

Content library includes costs capitalized for licensed streaming content, for production of original content and for DVD content.
Property and Equipment, Net
Property and equipment and accumulated depreciation consisted of the following:

	As of June 30, 2015	December 31, 2014	Estimated Useful Lives
	(in thousands)		
Information technology assets	$185,943	$ 189,274	3 years
Furniture and fixtures	25,825	25,758	3 years
Building	40,681	40,681	30 years
Leasehold improvements	61,453	57,339	Over life of lease
DVD operations equipment	89,132	89,144	5 years
Capital work-in-progress	50,135	12,495	
Property and equipment, gross	453,169	414,691	
Less: Accumulated depreciation	(281,773)	(264,816)	
Property and equipment, net	$171,396	$ 149,875	

Capital work-in-progress as of June 30, 2015 consists primarily of $41.5 million of leasehold improvements and furniture for the Company's headquarters expansion not yet placed into service.

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5. Long-term Debt

As of June 30, 2015, the Company had aggregate outstanding principal of $2.4 billion in long-term notes with varying maturities (the "Notes"). Each of the Notes were issued at par and are senior unsecured obligations of the Company. Interest is payable semi-annually at fixed rates.

The following table provides a summary of the Company's long-term debt as of June 30, 2015 and December 31, 2014:

	Principal Amount at Par (in millions)	Issuance Date	Maturity	Interest Due Dates	Level 2 Fair Value (1) as of June 30, 2015 (in millions)	Level 2 Fair Value (1) as of December 31, 2014
5.375% Senior Notes	$500.0	February 2013	2021	February 1 and August 1	$518.8	$ 520.0
5.750% Senior Notes	400.0	February 2014	2024	March 1 and September 1	411.0	416.0
5.50% Senior Notes (2)	700.0	February 2015	2022	April 15 and October 15	722.8	—
5.875% Senior Notes (2)	800.0	February 2015	2025	April 15 and October 15	828.1	—

(1) Based on quoted market prices in less active markets.

(2) The net proceeds to the Company for the 5.50% and 5.875% Senior Notes issued in the first quarter of 2015 were an aggregate $1,482.4 million. Debt issuance costs of $17.6 million were recorded in "Other non-current assets" on the Consolidated Balance Sheets and are amortized over the term of the notes as "Interest expense" on the Consolidated Statements of Operations.

Each of the Notes are repayable in whole or in part upon the occurrence of a change of control, at the option of the holders, at a purchase price in cash equal to 101% of the principal plus accrued interest. The Company may redeem the Notes prior to maturity in whole or in part at an amount equal to the principal amount thereof plus accrued and unpaid interest and an applicable premium. The Notes include, among other terms and conditions, limitations on the Company's ability to create, incur or allow certain liens; enter into sale and lease-back transactions; create, assume, incur or guarantee additional indebtedness of certain of the Company's subsidiaries; and consolidate or merge with, or convey, transfer or lease all or substantially all of the Company's and its subsidiaries assets, to another person. As of June 30, 2015 and December 31, 2014, the Company was in compliance with all related covenants.

6. Stockholders’ Equity

Stock Split

In March 2015, the Company's Board of Directors adopted an amendment to the Company's Certificate of Incorporation, to increase the number of shares of capital stock the Company is authorized to issue from 170,000,000 (160,000,000 shares of common stock and 10,000,000 shares of preferred stock), par value $0.001 to 5,000,000,000 (4,990,000,000 shares of common stock and 10,000,000 shares of preferred stock), par value $0.001. This amendment to the Company's certificate of incorporation was approved by the Company's stockholders at the 2015 Annual Meeting held on June 9, 2015.

On June 23, 2015, the Company's Board of Directors declared a seven-for-one stock split in the form of a stock dividend that was paid on July 14, 2015 to all shareholders of record as of July 2, 2015. Outstanding share and per-share amounts disclosed as of June 30, 2015 and for all other comparative periods presented have been retroactively adjusted to reflect the effects of the Stock Split.

Stock Option Plan

In June 2011, the Company adopted the 2011 Stock Plan. The 2011 Stock Plan provides for the grant of incentive stock options to employees and for the grant of non-statutory stock options, stock appreciation rights, restricted stock and restricted stock units to employees, directors and consultants. As of June 30, 2015, 18.1 million shares, as adjusted for the Stock Split, were reserved for future grants under the 2011 Stock Plan.

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A summary of the activities related to the Company’s stock option plans, as adjusted for the Stock Split, 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, 2014	20,025,208	22,845,417	$ 21.65		
Granted	(1,916,299)	1,916,299	66.07		
Exercised		(3,093,944)	11.01		
Balances as of June 30, 2015	18,108,909	21,667,772	$ 27.09	6.40	$ 1,446,423
Vested and exercisable as of June 30, 2015		21,667,772	$ 27.09	6.40	$ 1,446,423

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company’s closing stock price on the last trading day of the second quarter of 2015 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 the last trading day of the second quarter of 2015. This amount changes based on the fair market value of the Company’s common stock.

A summary of the amounts related to option exercises, is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
	(in thousands)			
Total intrinsic value of options exercised	$114,783	$46,179	$195,621	$147,720
Cash received from options exercised	$23,804	$14,469	$34,720	$46,917

Stock-based Compensation

The following table summarizes the assumptions used to value stock option grants using the lattice-binomial model and the valuation data, as adjusted for the Stock Split:

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Dividend yield	— %	— %	— %	— %
Expected volatility	36 %	45 %	36 %	45% - 48%
Risk-free interest rate	2.05 %	2.66 %	2.03% - 2.05%	2.66% - 2.83%
Suboptimal exercise factor	2.47	2.66 - 4.20	2.47 -2.48	2.66 - 4.20
Valuation data:				
Weighted-average fair value (per share)	$32.52	$28.13	$29.24	$29.69
Total stock-based compensation expense (in thousands)	$28,590	$29,285	$56,031	$55,110
Total income tax benefit related to stock options (in thousands)	$10,796	$11,225	$21,188	$21,124

The Company considers several factors in determining the suboptimal exercise factor, including the historical and estimated option exercise behavior and the employee groupings. Prior to January 1, 2015, the Company bifurcated its option grants into two employee groupings (executive and non-executive) to determine the suboptimal exercise factor. Beginning on January 1, 2015, the Company began aggregating employee groupings for its determination of the suboptimal exercise factor as the previous bifurcation into two groupings did not have a material impact on the fair value of the options granted.

Prior to January 1, 2015, the Company's computation of expected volatility was based on a blend of historical volatility of its common stock and implied volatility of tradable forward call options to purchase shares of its common stock, as low trade volume of its tradable forward call options prior to 2011 precluded sole reliance on implied volatility. Beginning on January 1, 2015, expected volatility is based solely on implied volatility. The Company believes that implied volatility of publicly traded options in its common stock is more reflective of market conditions, and given consistently high trade volumes of the options, can reasonably be expected to be a better indicator of expected volatility than historical volatility of its common stock.

In valuing shares issued under the Company’s employee stock option plans, the Company bases the risk-free interest rate on U.S. Treasury zero-coupon issues with terms similar to the contractual term of the options. The Company does not anticipate paying any cash

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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.

7. Accumulated Other Comprehensive Loss

The following table summarizes the changes in the accumulated balance of other comprehensive loss, net of tax, for the three and six months ended June 30, 2015:

	Foreign currency	Change in unrealized gains on available-for-sale securities	Total
	(in thousands)		
Balance as of March 31, 2015	$(44,105)	$ 951	$(43,154)
Other comprehensive (loss) income before reclassifications	5,560	(413)	5,147
Amounts reclassified from accumulated other comprehensive loss	—	(113)	(113)
Net increase (decrease) in other comprehensive (loss) income	5,560	(526)	5,034
Balance as of June 30, 2015	$(38,545)	$ 425	$(38,120)

	Foreign currency	Change in unrealized gains on available-for-sale securities	Total
	(in thousands)		
Balance as of December 31, 2014	$(4,615)	$ 169	$(4,446)
Other comprehensive (loss) income before reclassifications	(33,930)	433	(33,497)
Amounts reclassified from accumulated other comprehensive loss	—	(177)	(177)
Net increase (decrease) in other comprehensive (loss) income	(33,930)	256	(33,674)
Balance as of June 30, 2015	$(38,545)	$ 425	$(38,120)

As discussed in Note 1, other comprehensive loss for the six months ended June 30, 2015 includes the impact of the change in functional currency for certain of the Company's European entities.

All amounts reclassified from accumulated other comprehensive loss were related to realized gains on available-for-sale securities. These reclassifications impacted "Interest and other income (expense)" on the Consolidated Statements of Operations.

8. Income Taxes

The effective tax rates for the three months ended June 30, 2015 and 2014 were 35% and 39%, respectively. The effective tax rates for the six months ended June 30, 2015 and 2014 were 37% and 40%, respectively. The effective tax rates for the three and six months ended June 30, 2015 and 2014 differed from the federal statutory rate primarily due to state taxes, foreign taxes and non-deductible expenses, partially offset by the California R&D credit.

The decrease in the Company's effective tax rates for the three and six months ended June 30, 2015 as compared to the three and six months ended June 30, 2014 was primarily attributable to lower tax reserves on uncertain tax positions following an IRS Appeals settlement in the fourth quarter of 2014.

Gross unrecognized tax benefits were $38.1 million and $34.8 million as of June 30, 2015 and December 31, 2014, respectively. The gross unrecognized tax benefits, if recognized by the Company, will result in a reduction of approximately $31.5 million to the provision for income taxes thereby favorably impacting the Company's effective tax rate. The Company's unrecognized tax benefits are classified as "Other non-current liabilities" on the Consolidated Balance Sheets. The Company includes interest and penalties related to unrecognized tax benefits within the "Provision for income taxes" on the Consolidated Statements of Operations. As of June 30, 2015, the total amount of gross interest and penalties accrued was $0.4 million, and is classified as "Other non-current liabilities" on the Consolidated Balance Sheets.

Deferred tax assets include $15.8 million and $13.4 million classified as "Other current assets" and $145.7 million and $106.9 million classified as "Other non-current assets" on the Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014, respectively. In evaluating its ability to realize the net deferred tax assets, the Company considered all available positive and negative evidence, including its past operating results and the forecast of future market growth, forecasted earnings, future taxable income, and prudent and feasible tax

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planning strategies. As of June 30, 2015 and December 31, 2014, it was considered more likely than not that all deferred tax assets would be realized.

Income tax benefits attributable to the exercise of employee stock options of $39.1 million and $14.6 million, during the three months ended June 30, 2015 and 2014, respectively. Income tax benefits attributable to the exercise of employee stock options of $67.9 million and $47.1 million, during the six months ended June 30, 2015 and 2014, respectively. These benefits were recorded directly to "Additional paid-in capital" on the Consolidated Balance Sheets.

The Company files U.S. federal, state and foreign tax returns. The Company is currently under examination by the IRS for the years 2010 through 2013. The Company is also currently under examination by the state of California for the years 2006 and 2007. California has completed its Field Exam of the 2006 and 2007 California tax returns and has issued a Notice of Proposed Assessment primarily related to the Company's R&D Credits claimed in those years. The Company has filed a protest against the proposed assessment and is currently in the midst of the Franchise Tax Board Protest process. The years 1997 through 2005, as well as 2008 through 2013 remain subject to examination by the state of California. The Company has no significant foreign jurisdiction audits underway. The years 2011 through 2014 remain subject to examination by foreign jurisdictions. Given the potential outcome of the current examinations, as well as the impact of the current examination on the potential expiration of the statute of limitations, it is reasonably possible that the balance of unrecognized tax benefits could significantly change within the next twelve months. However, at this time, an estimate of the range of reasonably possible adjustments to the balance of unrecognized tax benefits cannot be made.

9. Commitments and Contingencies

Streaming Content

As of June 30, 2015, the Company had $10.1 billion of obligations comprised of $2.5 billion included in "Current content liabilities" and $1.9 billion of "Non-current content liabilities" on the Consolidated Balance Sheets and $5.7 billion of obligations that are not reflected on the Consolidated Balance Sheets.

As of December 31, 2014, the Company had $9.5 billion of obligations comprised of $2.1 billion included in "Current content liabilities" and $1.6 billion of "Non-current content liabilities" on the Consolidated Balance Sheets and $5.8 billion of obligations that are not reflected on the Consolidated Balance Sheets.

The expected timing of payments for these streaming content obligations is as follows:

	As of June 30, 2015	December 31, 2014
	(in thousands)	
Less than one year	$4,271,285	$ 3,747,648
Due after one year and through three years	4,791,033	4,495,103
Due after three years and through five years	961,784	1,164,308
Due after five years	49,307	44,053
Total streaming content obligations	$10,073,409	$ 9,451,112

A streaming content obligation is incurred at the time the Company enters into an agreement to obtain future titles. Once a title becomes available, a content liability is generally recorded on the Consolidated Balance Sheets. Certain agreements include the obligation to license rights for unknown future titles, the ultimate quantity and/or fees for which are not yet determinable as of the reporting date. The Company does not include any estimated obligation for these future titles beyond the known minimum amount. However, the unknown obligations are expected to be significant and the expected timing of payments could range from less than one year to more than five years.

The Company has entered into certain licenses with performing rights organizations ("PROs"), and is currently involved in negotiations with other PROs, that hold certain rights to music and other entertainment works "publicly performed" in connection with streaming content into various territories. Accruals for estimated license fees are recorded and then adjusted based on any change in estimates. These amounts are included in the streaming content obligations. The results of these negotiations are uncertain and may be materially different from management's estimates.

Legal Proceedings

From time to time, in the normal course of its operations, the Company is subject to litigation matters and claims, including claims relating to employee relations, business practices and patent infringement. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict and the Company's view of these matters may change in the future as the litigation and events related thereto unfold. The Company expenses legal fees as incurred. The Company records a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. An

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unfavorable outcome to any legal matter, if material, could have an adverse effect on the Company's operations or its financial position, liquidity or results of operations.

On January 13, 2012, the first of three purported shareholder class action lawsuits was filed in the United States District Court for the Northern District of California against the Company and certain of its officers and directors. Two additional purported shareholder class action lawsuits were filed in the same court on January 27, 2012 and February 29, 2012 alleging substantially similar claims. These lawsuits were consolidated into In re Netflix, Inc., Securities Litigation, Case No. 3:12-cv-00225-SC, and the Court selected lead plaintiffs. On June 26, 2012, lead plaintiffs filed a consolidated complaint which alleged violations of the federal securities laws. The Court dismissed the consolidated complaint with leave to amend on February 13, 2013. Lead plaintiffs filed a first amended consolidated complaint on March 22, 2013. The Court dismissed the first amended consolidated complaint with prejudice on August 20, 2013, and judgment was entered on September 27, 2013. Lead plaintiffs filed a motion to alter or amend the judgment and requested leave to file a second amended complaint on October 25, 2013. On January 17, 2014, the Court denied that motion. On February 18, 2014, lead plaintiffs appealed that decision to the United States Court of Appeals for the Ninth Circuit. Management has determined a potential loss is reasonably possible however, based on its current knowledge, management does not believe that the amount of such possible loss or a range of potential loss is reasonably estimable

On November 23, 2011, the first of six purported shareholder derivative suits was filed in the Superior Court of California, Santa Clara County, against the Company and certain of its officers and directors. Five additional purported shareholder derivative suits were subsequently filed: two in the Superior Court of California, Santa Clara County on February 9, 2012 and May 2, 2012; and three in the United States District Court for the Northern District of California on February 13, 2012, February 24, 2012 and April 2, 2012. The purported shareholder derivative suits filed in the Northern District of California have been voluntarily dismissed. On July 5, 2012, the purported shareholder derivative suits filed in Santa Clara County were consolidated into In re Netflix, Inc. Shareholder Derivative Litigation, Case No. 1-12-cv-218399, and lead counsel was appointed. A consolidated complaint was filed on December 4, 2012, with plaintiffs seeking compensatory damages and other relief. The consolidated complaint alleges, among other things, that certain of the Company's current and former officers and directors breached their fiduciary duties, issued false and misleading statements primarily regarding the Company's streaming business, violated accounting rules concerning segment reporting, violated provisions of the California Corporations Code, and wasted corporate assets. The consolidated complaint further alleges that the defendants caused the Company to buy back stock at artificially inflated prices to the detriment of the Company and its shareholders while contemporaneously selling personally held Company stock. The Company filed a demurrer to the consolidated complaint and a motion to stay the derivative litigation in favor of the related federal securities class action on February 4, 2013. On June 21, 2013, the Court granted the motion to stay the derivative litigation pending resolution of the related federal securities class action. Management has determined a potential loss is reasonably possible however, based on its current knowledge, management does not believe that the amount of such possible loss or a range of potential loss is reasonably estimable.

The Company is involved in other litigation matters not listed above but does not consider the matters to be material either individually or in the aggregate at this time. The Company's view of the matters not listed may change in the future as the litigation and events related thereto unfold.

Indemnification

In the ordinary course of business, the Company has entered into contractual arrangements under which it has agreed 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 the Company's 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.

The Company's obligations under these agreements may be limited in terms of time or amount, and in some instances, the Company may have recourse against third parties for certain payments. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers that will require it, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. 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 the Company’s obligations and the unique facts and circumstances involved in each particular agreement. No amount has been accrued in the accompanying consolidated financial statements with respect to these indemnification obligations.

10. Segment Information

The Company has three reportable segments: Domestic streaming, International streaming and Domestic DVD. Segment information is presented in the same manner that the Company’s chief operating decision maker ("CODM") reviews the operating results in assessing performance and allocating resources. The Company’s CODM reviews revenues and contribution profit (loss) for each of the reportable segments. Contribution profit (loss) is defined as revenues less cost of revenues and marketing expenses directly incurred by the segment. The Company has aggregated the results of the International operating segments into one reportable segment because these operating segments share similar long-term economic and other qualitative characteristics.

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The Domestic and International streaming segments derive revenues from monthly membership fees for services consisting solely of streaming content. The Domestic DVD segment derives revenues from monthly membership fees for services consisting solely of DVD-by-mail. Revenues and the related payment card fees are attributed to the operating segment based on the nature of the underlying membership (streaming or DVD) and the geographic region from which the membership originates. There are no internal revenue transactions between the Company's segments. Cost of revenues are primarily attributed to the operating segment based on the amounts directly incurred by the segment to obtain content and deliver it to the specific region. Content rights increasingly include multiple geographies as the Company aspires to obtain global content rights to support global expansion. The Company allocates this content between the International and Domestic segments based on estimated fair market value. Marketing expenses are primarily comprised of advertising expenses which are generally included in the segment in which the expenditures are directly incurred.

The Company's long-lived tangible assets were located as follows:

	As of	
	June 30, 2015	December 31, 2014
	(in thousands)	
United States	$160,135	$138,704
International	11,261	11,171

The following table represents segment information for the quarter ended June 30, 2015:

	As of/ Three Months Ended June 30, 2015			
	Domestic Streaming	International Streaming	Domestic DVD	Consolidated
	(in thousands)			
Total memberships at end of period (1)	42,300	23,251	5,314	—
Revenues	$1,025,913	$454,763	$164,018	$1,644,694
Cost of revenues	612,691	422,966	86,095	1,121,752
Marketing	73,427	123,713	—	197,140
Contribution profit (loss)	$339,795	$(91,916)	$77,923	$325,802
Other operating expenses				250,967
Operating income				74,835
Other income (expense)				(34,345)
Provision for income taxes				14,155
Net income				$26,335

	As of/ Six Months Ended June 30, 2015			
	Domestic Streaming	International Streaming	Domestic DVD	Consolidated
	(in thousands)			
Total memberships at end of period (1)	42,300	23,251	5,314	—
Revenues	$2,010,445	$870,160	$337,218	$3,217,823
Cost of revenues	1,195,220	798,244	174,689	2,168,153
Marketing	162,978	228,839	—	391,817
Contribution profit (loss)	$652,247	$(156,923)	$162,529	$657,853
Other operating expenses				485,562
Operating income				172,291
Other income (expense)				(93,375)
Provision for income taxes				28,885

Net income	$ 50,031

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The following table represents segment information for the quarter ended June 30, 2014:

	As of/ Three Months Ended June 30, 2014			
	Domestic Streaming	International Streaming	Domestic DVD	Consolidated
	(in thousands)			
Total memberships at end of period (1)	36,244	13,801	6,261	—
Revenues	$838,225	$ 307,461	$194,721	$ 1,340,407
Cost of revenues	546,223	266,697	101,928	914,848
Marketing	64,727	56,036	—	120,763
Contribution profit (loss)	$227,275	$ (15,272)	$92,793	$ 304,796
Other operating expenses				175,196
Operating income				129,600
Other income (expense)				(12,228)
Provision for income taxes				46,354
Net income				$ 71,018

	As of/ Six Months Ended June 30, 2014			
	Domestic Streaming	International Streaming	Domestic DVD	Consolidated
	(in thousands)			
Total memberships at end of period (1)	36,244	13,801	6,261	—
Revenues	$1,636,842	$ 574,579	$399,075	$ 2,610,496
Cost of revenues	1,063,317	511,964	208,753	1,784,034
Marketing	144,985	112,876	—	257,861
Contribution profit (loss)	$428,540	$ (50,261)	$190,322	$ 568,601
Other operating expenses				341,406
Operating income				227,195
Other income (expense)				(20,879)
Provision for income taxes				82,183
Net income				$ 124,133

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The following table represents the amortization of the content library:

	Domestic Streaming	International Streaming	Domestic DVD	Consolidated
	(in thousands)			
Three months ended June 30,				
2015	$462,228	$ 360,372	$20,813	$ 843,413
2014	409,896	229,141	16,923	655,960
Six months ended June 30,				
2015	894,217	677,901	41,998	1,614,116
2014	796,211	443,561	33,044	1,272,816

The following table represents total content library, net:

	Domestic Streaming	International Streaming	Domestic DVD	Consolidated
	(in thousands)			
As of June 30, 2015	$4,213,101	$1,910,847	$27,765	$6,151,713
As of December 31, 2014	3,476,226	1,392,701	30,101	4,899,028

(1) A membership (also referred to as a subscription or member) is defined as the right to receive either the Netflix streaming service or Netflix DVD service. Memberships are assigned to territories based on the geographic location used at time of sign up as determined by the Company's internal systems, which utilize industry standard geo-location technology. The Company offers free-trial memberships to new and certain rejoining members. For inclusion in the definition of a membership in the above metrics, a method of payment is required to be provided even during the free-trial period. Total memberships therefore include those who are on a free-trial and have provided a method of payment. A membership is canceled and ceases to be reflected in the above metrics as of the effective cancellation date. Voluntary cancellations become effective at the end of the prepaid membership period, while involuntary cancellation of the service, as a result of a failed method of payment, becomes effective immediately.

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