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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 30, 2004

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

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### Netflix, Inc.

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**77-0467272**  
(I.R.S. Employer  
Identification Number)

**970 University Avenue, Los Gatos, California 95032**  
(Address and zip code of principal executive offices)

**(408) 317-3700**  
(Registrant's telephone number, including area code)

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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 ☒ NO ☐ .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES ☒ NO ☐ .

As of July 19, 2004, there were 52,151,951 shares of the registrant's common stock, par value \$0.001, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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**Netflix, Inc.**  
**Statements of Operations**  
**(unaudited)**  
**(in thousands, except per share data)**

|                                                                                | Three Months Ended |                  | Six Months Ended |                  |
|--------------------------------------------------------------------------------|--------------------|------------------|------------------|------------------|
|                                                                                | June 30,<br>2003   | June 30,<br>2004 | June 30,<br>2003 | June 30,<br>2004 |
| Revenues:                                                                      |                    |                  |                  |                  |
| Subscription                                                                   | \$63,071           | \$119,710        | \$118,352        | \$219,533        |
| Sales                                                                          | 116                | 611              | 504              | 1,158            |
| Total revenues                                                                 | 63,187             | 120,321          | 118,856          | 220,691          |
| Cost of revenues:                                                              |                    |                  |                  |                  |
| Subscription                                                                   | 35,148             | 69,604           | 65,076           | 126,048          |
| Sales                                                                          | 93                 | 184              | 172              | 367              |
| Total cost of revenues                                                         | 35,241             | 69,788           | 65,248           | 126,415          |
| Gross profit                                                                   | 27,946             | 50,533           | 53,608           | 94,276           |
| Operating expenses:                                                            |                    |                  |                  |                  |
| Fulfillment*                                                                   | 7,221              | 14,373           | 13,604           | 25,163           |
| Technology and development*                                                    | 4,123              | 5,652            | 8,306            | 10,691           |
| Marketing*                                                                     | 9,957              | 20,477           | 23,164           | 47,170           |
| General and administrative*                                                    | 2,093              | 3,280            | 4,341            | 6,416            |
| Stock-based compensation                                                       | 1,704              | 4,134            | 4,110            | 8,569            |
| Total operating expenses                                                       | 25,098             | 47,916           | 53,525           | 98,009           |
| Operating income (loss)                                                        | 2,848              | 2,617            | 83               | (3,733)          |
| Other income (expense):                                                        |                    |                  |                  |                  |
| Interest and other income                                                      | 560                | 304              | 1,141            | 895              |
| Interest and other expense                                                     | (95)               | (30)             | (286)            | (61)             |
| Net income (loss)                                                              | \$ 3,313           | \$ 2,891         | \$ 938           | \$ (2,899)       |
| Net income (loss) per share:                                                   |                    |                  |                  |                  |
| Basic                                                                          | \$ 0.07            | \$ 0.06          | \$ 0.02          | \$ (0.06)        |
| Diluted                                                                        | \$ 0.05            | \$ 0.04          | \$ 0.02          | \$ (0.06)        |
| Weighted-average common shares outstanding:                                    |                    |                  |                  |                  |
| Basic                                                                          | 47,296             | 51,898           | 46,385           | 51,590           |
| Diluted                                                                        | 61,624             | 64,975           | 60,272           | 51,590           |
| * Amortization of stock-based compensation not included in expense line items: |                    |                  |                  |                  |
| Fulfillment                                                                    | \$ 207             | \$ 465           | \$ 540           | \$ 976           |
| Technology and development                                                     | 654                | 1,866            | 1,489            | 3,492            |
| Marketing                                                                      | 269                | 582              | 697              | 1,146            |
| General and administrative                                                     | 574                | 1,221            | 1,384            | 2,955            |
| Total stock-based compensation                                                 | \$ 1,704           | \$ 4,134         | \$ 4,110         | \$ 8,569         |

See accompanying notes to financial statements.

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**Netflix, Inc.**  
**Balance Sheets**  
**(unaudited)**  
**(in thousands, except share and par value data)**

|                                                                                                                                                                                                                                                  | As of                |                  |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|------------------|
|                                                                                                                                                                                                                                                  | December 31,<br>2003 | June 30,<br>2004 |
| <b>Assets</b>                                                                                                                                                                                                                                    |                      |                  |
| Current assets:                                                                                                                                                                                                                                  |                      |                  |
| Cash and cash equivalents                                                                                                                                                                                                                        | \$ 89,894            | \$ 153,444       |
| Short-term investments                                                                                                                                                                                                                           | 45,297               | —                |
| Prepaid expenses                                                                                                                                                                                                                                 | 2,231                | 2,422            |
| Prepaid revenue sharing expenses                                                                                                                                                                                                                 | 905                  | 2,214            |
| Other current assets                                                                                                                                                                                                                             | 619                  | 641              |
| Total current assets                                                                                                                                                                                                                             | 138,946              | 158,721          |
| DVD library, net                                                                                                                                                                                                                                 | 22,238               | 30,256           |
| Intangible assets, net                                                                                                                                                                                                                           | 2,948                | 1,868            |
| Property and equipment, net                                                                                                                                                                                                                      | 9,772                | 11,053           |
| Deposits                                                                                                                                                                                                                                         | 1,272                | 1,481            |
| Other assets                                                                                                                                                                                                                                     | 836                  | 814              |
| Total assets                                                                                                                                                                                                                                     | \$ 176,012           | \$ 204,193       |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                                                                                                                      |                      |                  |
| Current liabilities:                                                                                                                                                                                                                             |                      |                  |
| Accounts payable                                                                                                                                                                                                                                 | \$ 32,654            | \$ 42,552        |
| Accrued expenses                                                                                                                                                                                                                                 | 11,625               | 13,852           |
| Deferred revenue                                                                                                                                                                                                                                 | 18,324               | 25,251           |
| Current portion of capital lease obligations                                                                                                                                                                                                     | 416                  | 253              |
| Total current liabilities                                                                                                                                                                                                                        | 63,019               | 81,908           |
| Deferred rent                                                                                                                                                                                                                                    | 241                  | 379              |
| Capital lease obligations, less current portion                                                                                                                                                                                                  | 44                   | —                |
| Total liabilities                                                                                                                                                                                                                                | 63,304               | 82,287           |
| Stockholders' equity:                                                                                                                                                                                                                            |                      |                  |
| Common stock, \$0.001 par value; 80,000,000 and 160,000,000 shares authorized at December 31, 2003 and June 30, 2004, respectively; 50,849,370 and 52,121,300 shares issued and outstanding at December 31, 2003 and June 30, 2004, respectively | 51                   | 52               |
| Additional paid-in capital                                                                                                                                                                                                                       | 270,836              | 282,278          |
| Deferred stock-based compensation                                                                                                                                                                                                                | (5,482)              | (4,232)          |
| Accumulated other comprehensive income                                                                                                                                                                                                           | 596                  | —                |
| Accumulated deficit                                                                                                                                                                                                                              | (153,293)            | (156,192)        |
| Total stockholders' equity                                                                                                                                                                                                                       | 112,708              | 121,906          |
| Total liabilities and stockholders' equity                                                                                                                                                                                                       | \$ 176,012           | \$ 204,193       |

See accompanying notes to financial statements.

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### Netflix, Inc. Statements of Cash Flows (unaudited) (in thousands)

|                                                                                          | Three Months Ended |                  | Six Months Ended |                  |
|------------------------------------------------------------------------------------------|--------------------|------------------|------------------|------------------|
|                                                                                          | June 30,<br>2003   | June 30,<br>2004 | June 30,<br>2003 | June 30,<br>2004 |
| <b>Cash flows from operating activities:</b>                                             |                    |                  |                  |                  |
| Net income (loss)                                                                        | \$ 3,313           | \$ 2,891         | \$ 938           | \$ (2,899)       |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                    |                  |                  |                  |
| Depreciation of property and equipment                                                   | 1,140              | 1,323            | 2,473            | 2,575            |
| Amortization of DVD library                                                              | 9,392              | 21,141           | 16,012           | 39,268           |
| Amortization of intangible assets                                                        | 808                | 454              | 1,617            | 1,080            |
| Stock-based compensation expense                                                         | 1,704              | 4,134            | 4,110            | 8,569            |
| Loss on disposal of short-term investments                                               | —                  | 274              | —                | 274              |
| Gain on disposal of DVDs                                                                 | (94)               | (427)            | (461)            | (791)            |
| Non-cash interest expense                                                                | 36                 | 11               | 68               | 22               |
| Changes in operating assets and liabilities:                                             |                    |                  |                  |                  |
| Prepaid expenses and other current assets                                                | (398)              | (2,521)          | 205              | (1,522)          |
| Accounts payable                                                                         | 5,791              | (631)            | 7,659            | 9,898            |
| Accrued expenses                                                                         | 769                | 1,391            | 1,192            | 2,227            |
| Deferred revenue                                                                         | 1,167              | 3,755            | 2,651            | 6,927            |
| Deferred rent                                                                            | (8)                | 171              | (17)             | 138              |
| Net cash provided by operating activities                                                | 23,620             | 31,966           | 36,447           | 65,766           |
| <b>Cash flows from investing activities:</b>                                             |                    |                  |                  |                  |
| Purchases of short-term investments                                                      | (363)              | (222)            | (743)            | (586)            |
| Proceeds from sale of short                                                              |                    |                  |                  |                  |
|                                                                                          |                    |                  |                  | 3,895            |
| Net increase in cash and cash equivalents                                                | 5,201              | 53,256           | 11,415           | 63,550           |
| Cash and cash equivalents, beginning of period                                           | 66,028             | 100,188          | 59,814           | 89,894           |
| Cash and cash equivalents, end of period                                                 | \$ 71,229          | \$153,444        | \$ 71,229        | \$153,444        |

See accompanying notes to financial statements.

**Netflix, Inc.**  
**Notes to Financial Statements**  
**(in thousands, except shares, per share data and percentages)**

**Description of Business**

Netflix, Inc. (the “Company” or “we”) was incorporated on August 29, 1997 and began operations on April 14, 1998. The Company is an online movie rental subscription service, providing subscribers with access to a comprehensive library of titles. For a monthly subscription fee under the standard plan, subscribers can rent as many digital video discs (“DVDs”) as they want, with three movies out at a time, and keep them for as long as they like. There are no due dates and no late fees. DVDs are delivered directly to the subscriber’s address by first-class mail from distribution centers throughout the United States. The Company also provides background information on the Company’s Web site ([www.netflix.com](http://www.netflix.com)) on DVD releases, including critic reviews, member reviews, online trailers, ratings and personalized movie recommendations.

**Basis of Presentation**

The accompanying interim financial statements are unaudited and, in the opinion of management, include all adjustments, consisting of normal and recurring items, necessary for a fair presentation of the balance sheets, results of operations and cash flows for the periods presented. These financial statements should be read in conjunction with the audited financial statements and related notes included in the Company’s 2003 annual report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2004. Operating results for the three and six months ended June 30, 2004 may not be indicative of future operating results.

**Reclassifications**

Certain reclassifications have been made to prior period balances in order to conform to the current period’s presentation.

**Stock Split**

On January 16, 2004, the Company’s Board of Directors approved a two-for-one split in the form of a stock dividend on all outstanding shares of the Company’s common stock. As a result of the stock split, the Company’s stockholders received one additional share for each share of common stock held on the record date of February 2, 2004. The additional shares of common stock were distributed on February 11, 2004. All common share and per-share amounts in the accompanying interim financial statements and related notes have been retroactively adjusted to reflect the stock split for all periods presented.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant items subject to such estimates and assumptions include the carrying amounts of DVD library, intangible assets and property and equipment, stock-based compensation expenses and income taxes. Actual results could differ from those estimates.

**Fair Value of Financial Instruments**

The fair value of the Company’s cash, accounts payable, accrued expenses and borrowings approximates their carrying value due to their short maturity.

**Netflix, Inc.**  
**Notes to Financial Statements - Continued**  
**(in thousands, except shares, per share data and percentages)**

***Cash and Cash Equivalents***

The Company considers highly liquid instruments with original maturities of three months or less, at the date of purchase, to be cash equivalents. The Company's cash and cash equivalents are principally on deposit in short-term asset management accounts at two large financial institutions.

***Restricted Cash***

As of June 30, 2004, other assets included restricted cash of \$800 related to a workers' compensation insurance deposit.

***Short-Term Investments***

The Company's short-term investments generally mature between one and five years from the purchase date. The Company has the ability to convert these short-term investments into cash at anytime without penalty. All short-term investments are classified as available-for-sale and are recorded at market value. Net unrealized gains are reflected in accumulated other comprehensive income.

A decline in the market value of available-for-sale investments below cost that is deemed to be other-than-temporary results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the investments is established. To determine whether an impairment is other-than-temporary, the Company reviews factors including the economic environment and market conditions, its ability and intent to hold the investments until a market price recovery, and the severity and duration of the impairment. No impairment charges were recorded for the periods presented.

During the second quarter of 2004, the Company completed the sale of its short-term investments and recorded a realized loss of \$274 from the transaction. All proceeds from the sale were re-invested in the Company's money market fund, which is classified as cash equivalents.

***Capitalized Software Costs***

The Company capitalizes costs related to developing or obtaining internal-use software. Capitalization of costs begins after the conceptual formulation stage has been completed. Capitalized software costs are included in property and equipment, net and are amortized over the estimated useful life of the software, which is generally one year.

***DVD Library***

The Company acquires DVDs from studios and distributors through either direct purchases or revenue sharing agreements. The revenue sharing agreements enable the Company to obtain DVDs at a lower upfront cost than under traditional direct purchase arrangements. Under the revenue sharing agreements, the Company shares a percentage of the actual net revenues generated by the use of each particular title with the studios over a fixed period of time, or the Title Term, which is typically twelve months for each DVD title. At the end of the Title Term, the Company has the option of either returning the DVD title to the studio or purchasing the title.

In addition, the Company remits an upfront 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 library 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 amortizes the cost of its DVD library, less estimated salvage value, on a "sum-of-the-months" accelerated basis over one year.

For those DVDs that the Company estimates it will sell at the end of their useful lives, a salvage value of \$2.00 per DVD is provided. For those DVDs that the Company does not expect to sell, no salvage value is provided.