NETFLIX INC

FORM 10-Q
(Quarterly Report)

Filed 11/14/2002 For Period Ending 9/30/2002

Address	970 UNIVERSITY AVENUE .
	LOS GATOS, California 95032
Telephone	408-317-3700
CIK	0001065280
Industry	Recreational Activities
Sector	Services
Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2002

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 **(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) 399-3700
(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 ☒ NO ☐ .

As of November 6, 2002 there were 22,127,160 shares of the registrant's common stock, par value $0.001, outstanding.

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Netflix, Inc.

Index to Financial Statements

Table of Contents

Netflix, Inc.

Statements of Operations
(Unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2002	2001	2002
Revenues:				
Subscription	$18,444	$40,163	$ 52,893	$105,840
Sales	434	568	1,401	1,778
Total revenues	18,878	40,731	54,294	107,618
Cost of revenues:				
Subscription	9,667	21,147	38,620	53,798
Sales	176	349	622	948
Total cost of revenues	9,843	21,496	39,242	54,746
Gross profit	9,035	19,235	15,052	52,872
Operating expenses:				
Fulfillment *	3,283	4,908	10,485	13,917
Technology and development *	4,463	3,966	14,833	10,665
Marketing *	3,444	9,299	14,187	25,291
General and administrative *	1,003	1,870	3,548	4,817
Restructuring charges	671	—	671	—
Stock-based compensation	1,220	1,467	4,699	7,053
Total operating expenses	14,084	21,510	48,423	61,743
Operating loss	(5,049)	(2,275)	(33,371)	(8,871)
Interest and other income (expense), net	(505)	580	(782)	(10,761)
Net loss	$ (5,554)	$ (1,695)	$(34,153)	$ (19,632)
Net loss per share:				
Basic and diluted	$ (2.94)	$ (0.08)	$ (19.12)	$ (1.72)
Weighted average shares outstanding:				
Basic and diluted	1,891	21,922	1,786	11,395
* Amortization of stock-based compensation not included in expense line-item:				
Fulfillment	$ 276	$ 119	$ 995	$ 867
Technology and development	423	503	1,643	2,780
Marketing	285	299	1,134	1,790
General and administrative	236	546	927	1,616
	$ 1,220	$ 1,467	$ 4,699	$ 7,053

See accompanying notes to financial statements.

Netflix, Inc.

Balance Sheets
(Unaudited)
(in thousands, except share data)

	As of	
	December 31, 2001(1)	September 30, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 16,131	$ 54,321
Short-term investments	—	43,217
Prepaid expenses	1,019	1,807
Prepaid revenue sharing expenses	732	379
Other current assets	1,670	1,551
Total current assets	19,552	101,275
DVD library, net	3,633	7,070
Intangible assets, net	7,917	6,902
Property and equipment, net	8,205	5,870
Deposits	1,677	1,185
Other assets	646	605
Total assets	$ 41,630	$ 122,907
Liabilities and Stockholders' (Deficit) Equity		
Current liabilities:		
Accounts payable	$ 13,715	$ 18,148
Accrued expenses	4,544	8,108
Deferred revenue	4,937	7,179
Current portion of capital lease obligations	1,345	1,482
Notes payable	1,667	—
Total current liabilities	26,208	34,917
Deferred rent	240	285
Capital lease obligations, less current portion	1,057	394
Subordinated notes payable	2,799	—
Total liabilities	30,304	35,596
Commitments and contingency		
Redeemable convertible preferred stock	101,830	—
Stockholders' (deficit) equity:		
Convertible preferred stock, $0.001 par value; 8,500,000 shares authorized; 6,157,499 and no shares issued and outstanding at December 31, 2001 and September 30, 2002, respectively; aggregate liquidation preference of $2,222 at December 31, 2001 and $0 at September 30, 2002	6	—
Common stock, $0.001 par value; 100,000,000 and 150,000,000 shares authorized at December 31, 2001 and September 30, 2002, respectively; 2,161,855 and 22,069,068 issued and outstanding at December 31, 2001 and September 30, 2002, respectively	2	22
Additional paid-in capital	52,479	257,339
Deferred stock-based compensation	(5,725)	(13,755)
Accumulated other comprehensive income	—	603
Accumulated deficit	(137,266)	(156,898)
Total stockholders' (deficit) equity	(90,504)	87,311
Total liabilities and stockholders' (deficit) equity	$ 41,630	$ 122,907

(1) Derived from audited financial statements

See accompanying notes to financial statements.

Table of Contents

Netflix, Inc.

Statements of Cash Flows
(Unaudited)
(in thousands)

	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2002
Cash flows from operating activities:		
Net loss	$(34,153)	$ (19,632)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation of property, plant and equipment	3,995	4,481
Amortization of DVD library	20,052	11,568
Amortization of intangible assets	1,479	2,333
Noncash charges for equity instruments granted to non-employees	28	40
Stock-based compensation expense	4,699	7,053
Gain on disposal of DVDs	—	(1,469)
Noncash interest expense	554	11,353
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	616	(316)
Accounts payable	1,618	4,433
Accrued expenses	(1,166)	3,564
Deferred revenue	690	2,242
Deferred rent	114	45
Net cash (used in) provided by operating activities	(1,474)	25,695
Cash flows from investing activities:		
Purchases of short-term investments	—	(42,614)
Purchases of property and equipment	(2,668)	(1,563)
Acquisitions of DVD library	(5,844)	(15,314)
Proceeds from sale of DVDs	—	1,778
Deposits and other assets	(686)	533
Net cash used in investing activities	(9,198)	(57,180)
Cash flows from financing activities:		
Proceeds from issuance of common stock	94	86,606
Net proceeds from issuance of subordinated notes payable and detachable warrants	12,831	—
Repurchases of common stock	(7)	(3)
Principal payments on notes payable and capital lease obligations	(2,907)	(16,928)
Net cash (used in) provided by financing activities	10,011	69,675
Net increase (decrease) in cash and cash equivalents	(661)	38,190
Cash and cash equivalents, beginning of period	14,895	16,131
Cash and cash equivalents, end of period	$ 14,234	$ 54,321
Supplemental disclosure:		
Cash paid for interest	$ 627	$ 471
Noncash investing and financing activities:		
Purchase of assets under capital lease obligations	$ —	$ 583
Discount on capital lease obligation	$ 172	$ —
Exchange of Series F non-voting convertible preferred stock for intangible asset	$ 4,483	$ 1,318
Unrealized gain on short-term investments	$ —	$ 603
Conversion of redeemable convertible preferred stock to common stock	$ —	$101,830

See accompanying notes to financial statements.

Netflix, Inc.

Notes to Financial Statements
(in thousands, except share and per share data)

1. Basis of presentation

The accompanying unaudited financial statements have been prepared by Netflix, Inc. ("Netflix" or the "Company") and reflect all adjustments that are, in the opinion of management, necessary for fair presentation of the interim periods presented. Such adjustments are of a normal recurring nature. The results of operations for the interim periods presented are not necessarily indicative of the results for any future interim periods or for the entire fiscal year. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been omitted, although the Company believes that the disclosures included are adequate to make the information disclosed not misleading. The unaudited financial statements and notes herein should be read in conjunction with the audited financial statements and notes for the fiscal year ended December 31, 2001, which were included as part of the Company's registration statement on Form S-1 (File No. 333-83878), as declared effective by the Securities and Exchange Commission on May 22, 2002.

Description of business

The Company was incorporated on August 29, 1997 (inception) and began operations on April 14, 1998. The Company provides an online entertainment subscription service providing subscribers access to a comprehensive library of filmed entertainment titles formatted on digital video disk ("DVD"). The standard subscription plan provides subscribers access to an unlimited number of titles, with three titles out at a time, for $19.95 per month with no due dates or late fees. The subscribers select titles at the Company's website at www.netflix.com.

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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Initial public offering

On May 29, 2002, the Company closed the sale of 5,500,000 shares of common stock and on June 14, 2002, the Company closed the sale of an additional 825,000 shares of common stock, in an initial public offering at a price of $15.00 per share. A total of $94,875 in gross proceeds was raised from these transactions. After deducting the underwriting fee of approximately $6,641 and approximately $2,307 of other offering expenses, net proceeds were approximately $85,927. Upon the closing of the initial public offering, all preferred stock was automatically converted into common stock.

3. 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 three large financial institutions.

4. Short-term investments

Short-term investments generally mature between three months and three years from the purchase date. The Company has the ability to convert these short-term investments into cash at any point in time without penalty. All short-term investments are classified as available for sale and are recorded at market value using the specific identification method. Unrealized gains and losses are reflected in other comprehensive income and accumulated other comprehensive income.

5. DVD library

Historically, the Company purchased DVDs from studios and distributors. In 2000 and 2001, the Company entered into a series of revenue sharing agreements with several studios that changed the business model for acquiring DVDs and satisfying subscriber demand. These revenue sharing agreements enable the Company to obtain DVDs at a lower upfront cost than under traditional buying arrangements. 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, which is typically 12 months for each DVD title (hereinafter referred to as the "title term"). At the end of the title term, the Company has the option of either returning the DVD title to the studio or

Netflix, Inc.

Notes to Financial Statements—(continued)
(in thousands, except share and per share data)

purchasing the title. Before the change in business model, the Company typically acquired fewer copies of a particular title upfront and utilized each copy acquired over a longer period of time. The implementation of these revenue sharing agreements improved the Company's ability to obtain larger quantities of newly released titles and satisfy subscriber demand for such titles over a shorter period of time.

In connection with the change in business model, on January 1, 2001, the Company revised its amortization policy for the cost of its DVD library from an accelerated method using a three year life to the same accelerated method of amortization over one year. The change in life has been accounted for as a change in accounting estimate and is accounted for on a prospective basis from January 1, 2001. Had the one-year amortizable life been used beginning on January 1, 2000 instead of January 1, 2001, amortization expense for the three and nine months ended September 30, 2001 would have been $0.2 million and $10.1 million, respectively, lower than the amount recorded in our financial statements.

Under certain revenue sharing agreements the Company remits an upfront payment to acquire titles from the studios. 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. Some payments 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.

DVD library and accumulated amortization are as follows:

	As of	
	December 31, 2001	September 30, 2002
DVD library	$ 35,039	$ 50,044
Less accumulated amortization	$ (31,406)	$ (42,974)
DVD library, net	$ 3,633	$ 7,070

6. Intangible assets

During 2000, in connection with revenue sharing agreements with three studios, the Company agreed to issue each studio an equity interest equal to 1.204% of the Company's fully diluted equity securities outstanding in the form of Series F Non-Voting Convertible Preferred Stock ("Series F Preferred Stock"). In 2001, in connection with revenue sharing agreements with two additional studios, the Company agreed to issue each studio an equity interest equal to 1.204% of the Company's fully diluted equity securities outstanding in the form of Series F Preferred Stock.

The Company's obligation to maintain the studios' equity interests at 6.02% of the Company's fully diluted equity securities outstanding terminated immediately prior to its initial public offering. The studios' Series F Preferred Stock automatically converted into 1,596,415 shares of common stock upon the closing of the Company's initial public offering.

The Company measured the original issuances and any subsequent adjustments using the deemed fair value of the securities at the issuance and any subsequent adjustment dates. The deemed value was recorded as an intangible asset and is amortized to cost of subscription revenues ratably over the remaining term of the agreements which initial terms were either three or five years. Total gross intangible assets related to these agreements as of December 31, 2001 and September 30, 2002 was $10,210 and $11,528, respectively. Accumulated amortization as of December 31, 2001 and September 30, 2002 was $2,622 and $4,799, respectively.

During 2001, in connection with a strategic marketing alliance agreement, the Company issued 416,440 shares of Series F Preferred Stock. These shares automatically converted into 138,813 shares of common stock upon the closing of the Company's initial public offering. Under the agreement, the strategic partner has committed to provide, on a best-efforts basis, a stipulated number of impressions to a co-branded Web site and the Company's Web site over a period of 24 months. In addition, the Company is allowed to use the partner's trademark and logo in marketing the Company's subscription services. The Company recognized the deemed fair value of these instruments as an intangible asset with a corresponding credit to additional paid-in capital. The intangible asset is being amortized on a straight-line basis to marketing expense over the two-year term of the strategic marketing alliance. The gross intangible asset related to this agreement as of December 31, 2001 and September 30, 2002 was $416. Accumulated amortization as of December 31, 2001 and September 30, 2002 was $87 and $243, respectively.

Netflix, Inc.

Notes to Financial Statements—(continued)
(in thousands, except share and per share data)

7. Subordinated notes payable

In July 2001, the Company issued subordinated promissory notes and warrants to purchase 6,818,947 shares of its common stock at an exercise price of $3.00 per share for net proceeds of $12,831. The subordinated notes had an aggregate face value of $13,000 and stated interest rate of 10%. Approximately $10,884 of the proceeds was allocated to the warrants as additional paid-in capital and $1,947 was allocated to the subordinated notes payable. The resulting discount of $11,053 was being accreted to interest expense using an effective annual interest rate of 21%. The face value of the subordinated notes and all accrued interest were due and payable upon the earlier of July 2011 or the consummation of a qualified initial public offering. As of December 31, 2001 accrued and unpaid interest of $650 was included in the carrying amount of the subordinated notes payable balance of $2,799 in the accompanying financial statements. The Company consummated a qualified initial public offering on May 29, 2002 and repaid the face value and all accrued interest on the subordinated promissory notes. The repayment resulted in a non-cash interest expense of $10,695, related to the acceleration of the accretion of the discount, for the three months ended June 30, 2002 and for the nine months ended September 30, 2002.

8. Revenue recognition

Subscription revenues are recognized ratably during each subscriber's monthly subscription period. Refunds to customers are recorded as a reduction of revenues. Revenues from sales of DVDs are recorded upon shipment. Prior to adopting a subscription model, revenues from individual DVD rentals were recorded upon shipment.

9. Stock-based compensation

The Company accounts for its stock-based employee compensation plans using the intrinsic-value method. Deferred stock-based compensation expense is recorded if, on the date of grant, the current fair value of the underlying stock exceeds the exercise price. Deferred compensation resulting from repriced options is calculated pursuant to FASB Interpretation No. 44. Options granted to nonemployees are considered compensatory and are accounted for at fair value pursuant to Statement of Financial Accounting Standards (SFAS) No. 123.

In 2001, the Company offered employees and directors the right to exchange certain stock options. The Company exchanged options to purchase approximately 900,000 shares of common stock with varying exercise prices in exchange for options to purchase approximately 900,000 shares of common stock with an exercise price of $3.00 per share. As of September 30, 2002, exchanged options for approximately 700,000 shares of common stock were outstanding. The stock option exchange resulted in variable award accounting treatment for all of the exchanged options. Variable award accounting will continue until all options subject to variable accounting are exercised, cancelled or expire. Variable accounting treatment will result in unpredictable and potentially significant charges or credits to the Company's operating expenses from fluctuations in the market price of the Company's common stock. For each hypothetical one-dollar increase or decrease in the fair value of the Company's common stock, the Company will record deferred compensation in an amount equal to the number of shares underlying the variable awards multiplied by the one-dollar change. However, to the extent these variable awards are not fully vested, the stock-based compensation expense will be less than the amount we record as deferred compensation.

10. Comprehensive loss

Comprehensive loss consists of net loss and other gains and losses affecting stockholders' equity that, under generally accepted accounting principles, are excluded from net loss, such as unrealized gains and losses on investments available for sale. The balances in accumulated other comprehensive income consist of unrealized gains on short-term investments.

11. Net loss per share

Basic net loss per share is computed using the weighted-average number of outstanding shares of common stock, excluding common stock subject to repurchase. Diluted net loss per share is computed using the weighted-average number of outstanding shares of common stock and, when dilutive, potential common stock from outstanding options and warrants to purchase common stock, using the treasury stock method. All potential common stock issuances have been excluded from the computations of diluted net loss per share for all periods presented because the effect would be antidilutive.

Table of Contents

Netflix, Inc.

Notes to Financial Statements—(continued)
(in thousands, except share and per share data)

Diluted net loss per share does not include the effect of the following antidilutive common equivalent shares (rounded to nearest thousand):

	As of September 30, 2001	As of September 30, 2002	
	Shares	Shares	Weighted Average Exercise Price
Stock options outstanding	3,208	4,320	$ 3.23
Warrants outstanding	7,018	6,365	$ 3.22
Common stock subject to repurchase	193	28	$ 1.51
	10,419	10,713	$ 3.22
Redeemable convertible preferred stock	9,660	—	N/A
Convertible preferred stock	3,123	—	N/A
	23,202	10,713	N/A

12. Recently issued accounting standards

In April 2002, the Financial Accounting Standards Board (“FASB”) issued Financial Accounting Standard (“FAS”) 145 “Recision of FASB Statements no. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections Under Statement 4”, pursuant to which all gains and losses from extinguishments of debt were required to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. This statement eliminates Statement 4 and, thus, the exception to applying Opinion 30 to all gains and losses related to extinguishments of debt. The Company adopted FAS 145 during the nine months ended September 30, 2002, and as a result, has classified the charge related to the unamortized discount upon repayment of the subordinated notes payable as other expense, instead of extraordinary loss on extinguishment of debt, in the accompanying statements of operations.

13. Stock split

On May 17, 2002, the Company amended its Certificate of Incorporation to effect a one-for-three reverse stock split of the Company’s common stock. Accordingly, all share and per share amounts for the Company’s common stock including common stock options, common stock warrants and net loss per common share information have been restated to retroactively reflect the stock split.

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

Forward Looking Statements

This quarterly report contains certain forward-looking statements within the meaning of the federal securities laws, including statements regarding our expectations concerning our subscriber churn, the impact of competition on our revenues, amortization of intangible assets related to equity issued to studios, increased disc usage, gross profit, the expansion of our metropolitan shipping centers, the potential increase in marketing expenditures, and future stock-based compensation expense.

These statements are subject to risks and uncertainties that could cause actual results and events to differ, including: our ability to manage our growth, in particular managing our subscriber acquisition costs as well as the mix between revenue sharing titles and titles not subject to revenue sharing that are delivered to our subscribers; our ability to attract new subscribers and retain existing subscribers; fluctuations in consumer spending on DVD players, DVDs and related products; competition; deterioration of the U.S. economy or conditions specific to online commerce or the filmed entertainment industry; conditions that effect our delivery through the U.S. Postal Service, including increases in postage; increases in the costs of acquiring DVDs; and, widespread consumer adoption of different modes of viewing in-home filmed entertainment. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included as part of our registration statement on Form S-1 (File No. 333-83878), as declared effective by the Securities and Exchange Commission on May 22, 2002.

We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements contained in this quarterly report, or to explain why actual results differ.

Overview

We are the largest online entertainment subscription service in the United States providing more than 742,000 subscribers access to a comprehensive library of more than 12,000 movie, television and other filmed entertainment titles. Our standard subscription plan allows subscribers to have three titles out at the same time with no due dates, late fees or shipping charges for $19.95 per month. Subscribers can view as many titles as they want in a month. Subscribers select titles at our Web site (www.netflix.com) aided by our proprietary CineMatch technology, receive them on DVD by first-class mail and return them to us at their convenience using our prepaid mailers. Once a title has been returned, we mail the next available title in a subscriber's queue.

We were organized as a Delaware corporation in August 1997. We have incurred significant losses since our inception. We expect that we will continue to incur losses for the foreseeable future. We also expect to incur significant marketing, technology and development, general and administrative and stock-based compensation expenses. As a result, we will need to increase our operating margins to achieve net income.

Critical Accounting Policies

We believe the estimated life over which we amortize the costs of acquiring titles for our library and the selection of a method of amortization for the costs we incur to acquire titles for our library are critical accounting policies because they involve some of the more significant judgments and estimates used in the preparation of our financial statements.

Change in Estimated Life of the Cost of Our Library

In late 2000 and early 2001, we entered into a series of revenue sharing agreements with studios which substantially changed our business model for acquiring DVDs and satisfying subscriber demand for titles. These revenue sharing agreements enable us to acquire DVDs at a lower upfront cost than traditional buying arrangements. We share a percentage of the net revenues generated by the use of each particular title with these studios over a fixed period of time, generally 12 months. Before this change in our business model, we typically acquired fewer copies of a particular title and utilized each copy over a longer period of time. The implementation of these revenue sharing agreements improved our ability to acquire larger quantities of newly released titles and satisfy a substantial portion of subscriber demand for such titles over a shorter period of time. On January 1, 2001, we revised the amortization policy for the cost of our library from an accelerated method using a three-year life to the same accelerated method of amortization using a one-year life.

The change in life has been accounted for as a change in accounting estimate on a prospective basis from January 1, 2001. Had the one-year amortizable life been used beginning on January 1, 2000 instead of January 1, 2001, amortization expense for the three and nine months ended September 30, 2001 would have been $0.2 million and $10.1 million, respectively, lower than the amount recorded in our financial statements.

Selection of a Method of Amortization of Upfront Costs of Our Library

Under our revenue sharing agreements, we remit an upfront payment to acquire titles from the studios. This payment includes a contractually specified initial fixed license fee that is capitalized. Some payments also include a contractually specified prepayment of future revenue sharing obligations that is classified as prepaid revenue sharing expense and is expensed as revenue sharing obligations are incurred. The DVD acquisition costs are amortized on an accelerated basis over one year. We believe the use of an accelerated method is appropriate because we normally experience heavy initial demand for a title, which subsides once initial demand has been satisfied.

Results of Operations

The following table sets forth consolidated results of operations and other data (in thousands, except per share data, per subscriber data and percentages):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2002	2001	2002
Revenues:				
Subscription	$18,444	$40,163	$ 52,893	$105,840
Sales	434	568	1,401	1,778
Total revenues	18,878	40,731	54,294	107,618
Cost of revenues:				
Subscription	9,667	21,147	38,620	53,798
Sales	176	349	622	948
Total cost of revenues	9,843	21,496	39,242	54,746
Gross profit	9,035	19,235	15,052	52,872
Operating expenses:				
Fulfillment	3,283	4,908	10,485	13,917
Technology and development	4,463	3,966	14,833	10,665
Marketing	3,444	9,299	14,187	25,291
General and administrative	1,003	1,870	3,548	4,817
Restructuring charges	671	—	671	—
Stock-based compensation	1,220	1,467	4,699	7,053
Total operating expenses	14,084	21,510	48,423	61,743
Operating loss	(5,049)	(2,275)	(33,371)	(8,871)
Interest and other income (expense), net	(505)	580	(782)	(10,761)
Net loss	$ (5,554)	$ (1,695)	$(34,153)	$ (19,632)
Net loss per share:				
Basic and diluted	$ (2.94)	$ (.08)	$ (19.12)	$ (1.72)
Pro forma basic and diluted	$ (.38)	$ (.08)	$ (2.46)	$ (1.08)
Weighted average shares outstanding:				
Basic and diluted	1,891	21,922	1,786	11,395
Pro forma basic and diluted	14,540	21,922	13,856	18,110

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2002	2001	2002
Other data:				
(Unaudited)				
EBITDA:				
Operating loss	$(5,049)	$(2,275)	$(33,371)	$ (8,871)
Add back:				
Stock based compensation	1,220	1,467	4,699	7,053
Pro forma operating income (loss)	(3,829)	(808)	(28,672)	(1,818)
Depreciation of PP&E	1,319	1,576	3,995	4,481
Amortization of DVD Library	2,449	4,663	20,052	11,568
Amortization of Intangibles	667	808	1,479	2,333
Non-cash charges for equity granted to non-employees	8	40	28	40
EBITDA	$ 614	$ 6,279	$ (3,118)	$ 16,604
Pro forma net income (loss):				
Net loss	$(5,554)	$(1,695)	$(34,153)	$(19,632)
Add back:				
Restructuring charges	671	—	671	—
Stock-based compensation	1,220	1,467	4,699	7,053
Non-cash interest on early repayment of debt	—	—	—	10,695
Pro forma net income (loss)	$(3,663)	$ (228)	$(28,783)	$ (1,884)
Pro forma net income (loss) per share:				
Pro forma basic and diluted	$ (.25)	$ (.01)	$ (2.08)	$ (.10)
Subscribers:				
New Trial Subscribers: during period	107	277	339	825
New Trial Subscribers year to year change	(20%)	159%	(6%)	143%
New Trial Subscribers quarter to quarter sequential change	22%	17%		
Subscribers: end of period	334	742	334	742
Subscribers year to year change	40%	122%	40%	122%
Subscribers quarter to quarter sequential change	8%	11%		
Free subscribers: end of period	19	34	19	34
Free subscribers as percentage of ending subscribers	5.7%	4.6%	5.7%	4.6%
Paid subscribers: end of period	315	708	315	708
Subscriber churn (monthly)	6.5%	7.2%	7.9%	7.0%
Subscription revenue per average paid subscriber (monthly)	$ 20.12	$ 19.97	$ 20.31	$ 20.22
Subscriber Acquisition Cost	$ 32.19	$ 33.57	$ 41.85	$ 30.66
Margins:				
Gross margin	47.9%	47.2%	27.7%	49.1%
Operating margin	(26.7%)	(5.6%)	(61.5%)	(8.2%)
Pro forma operating margin	(20.3%)	(2.0%)	(52.8%)	(1.7%)
Net margin	(29.4%)	(4.2%)	(62.9%)	(18.2%)
Pro forma net margin	(19.4%)	(0.6%)	(53.0%)	(1.8%)
Expenses as percentage of revenues:				
Fulfillment	17.4%	12.0%	19.3%	12.9%
Technology and development	23.6%	9.7%	27.3%	9.9%
Marketing	18.2%	22.8%	26.1%	23.5%
General and administrative	5.3%	4.6%	6.5%	4.5%
Operating expenses before stock-based compensation and restructuring	64.6%	49.2%	79.3%	50.8%
Restructuring charges	3.6%	0.0%	1.2%	0.0%
Stock-based compensation	6.5%	3.6%	8.7%	6.6%

Total operating expenses	74.7%	52.8%	89.2%	57.4%
Year to year change:				
Subscription revenues	81.1%	117.8%	135.0%	100.1%
Sales revenues	100.0%	30.9%	100.0%	26.9%
Total revenues	85.4%	115.8%	141.3%	98.2%
Fulfillment	38.6%	49.5%	57.2%	32.7%
Technology and development	10.4%	(11.1%)	31.9%	(28.1%)
Marketing	(47.9%)	170.0%	(22.8%)	78.3%
Compensation and Restructuring	(46.2%)	86.4%	(19.1%)	35.8%

Unaudited Pro Forma Net Income (Loss) per Common Share —Pro forma basic net income (loss) per common share is computed by dividing net income or loss by the weighted average number of shares of common stock outstanding for the period (excluding shares subject to repurchase) plus the weighted average number of shares of common stock resulting from the assumed conversion of outstanding shares of convertible preferred stock upon the closing of the initial public offering as if the shares had been converted immediately upon their issuance. Pro forma diluted net loss per share is computed using the pro forma basic weighted-average number of outstanding shares of common stock and, when dilutive, potential common stock from outstanding options and warrants to purchase common stock, using the treasury stock method.

Churn —Average monthly churn for the quarter ended September 30, 2002 was 7.2%, representing an 0.5% increase from the average monthly churn of 6.7% for the quarter ended June 30, 2002. This increase was attributable primarily to a change in our Web site allowing online cancellation instead of requiring the use of an 800 number during business hours. The increase occurred primarily among new trial subscribers and across all new trial acquisition sources and geographic regions. We expect churn to remain in the 7 to 7.4% range in the fourth quarter of 2002. We calculate churn as a monthly percentage equal to a quotient, the numerator of which is the sum of the previous quarter's ending subscribers plus the current quarter's new trial subscribers minus the ending subscribers for the current quarter and the denominator of which is the sum of the previous quarter's ending subscribers plus the current quarter's new trial subscribers and then dividing this resulting number by 3, which is the number of months in the quarter. For example, assuming ending subscribers for the previous quarter of 670,000; new trial subscribers of 277,000 during the current quarter; current quarter ending subscribers of 740,000, gives a churn of 7.2% [i.e. ((670,000+277,000-740,000)/(670,000+277,000))/3 =7.2%].

Subscriber Acquisition Cost —We calculate subscriber acquisition cost by dividing the total marketing expense for the period by new trial subscribers during the period.

Three Months Ended September 30, 2002 Compared to Three Months Ended September 30, 2001

Revenues

We derive substantially all our revenues from monthly subscription fees. Periodically, we generate revenue from the sale of excess DVDs. We recognize subscription revenues ratably during each subscriber's monthly subscription period. We recognize revenues from the sale of used DVD's when the DVDs are shipped.

Our ability to sustain and grow our revenues may be adversely affected by, among other things, increased competition. Recently, Wal-Mart announced that it would begin testing a competing on-line DVD rental service called Wal-Mart DVD Rentals through its online affiliate Walmart.com. Walmart stated that it was launching the test for Wal-Mart DVD Rentals in October and, based on feedback it gathers from an initial group of customers, will fine-tune the service before rolling it out to all customers nationwide next year. In addition, Blockbuster continues to experiment with its in-store DVD rental subscription service, the DVD Freedom Pass, and recently announced that it is testing on-line DVD rentals through its subsidiary, filmcaddy.com, formerly dvdrentalcentral.com.

Subscription revenues . Our subscription revenues for the three months ended September 30, 2002 were $40.2 million, representing a 118% increase from our subscription revenues of $18.4 million for the three months ended September 30, 2001. The increase in total subscription revenues was caused by a 119% increase in the average number of paying subscribers from 306,000 during the three months ended September 30, 2001 to 671,000 during the three months ended September 30, 2002. We believe the average number of subscribers increased for several reasons including the continuing consumer adoption of DVD players, our increasingly effective marketing programs and the opening of our regional distribution centers.

Sales revenues . Our sales revenues for the three months ended September 30, 2002 were $0.6 million, representing a 31% increase from our sales revenues of $0.4 million for the three months ended September 30, 2001. This increase was attributable to an increase in our sale of used DVDs to resellers.

Cost of Revenues

Cost of subscription revenues consists of revenue sharing costs, amortization of our library, amortization of intangible assets related to equity investments issued to certain studios and postage and packaging costs related to shipping titles to paying subscribers. Cost of revenues for DVD sales includes salvage value and revenue sharing costs for used DVDs sold.

Cost of subscription revenues . Cost of subscription revenues for the three months ended September 30, 2002 was $21.1 million, representing a 119% increase from our cost of subscription revenues of $9.7 million for the three months ended September 30, 2001. This increase was attributable primarily to the net effect of the following:

> *Revenue sharing costs* . Our revenue sharing costs for the three months ended September 30, 2002 were $7.9 million, representing a 128% increase from our revenue sharing costs of $3.5 million for the three months ended September 30, 2001. This increase was due primarily to a 119% increase in average number of paying subscribers between the three months ended September 30, 2001 and 2002, coupled with an increase in the mix between titles delivered to subscribers that were subject to revenue sharing versus titles that were not subject to revenue sharing. As a percentage of revenues, our revenue sharing costs increased from 18.3% in the three months ended September 30, 2001 to 19.4% during the three months ended September 30, 2002.

DVD amortization costs . Our DVD amortization costs for the three months ended September 30, 2002 were $4.2 million, representing an 84% increase from our DVD amortization costs of $2.3 million for the three months ended September 30, 2001. The increase was due primarily to increased DVD acquisitions for our library to support our increased subscriber base.

Amortization of intangible assets related to equity issued to studios . For the three months ended September 30, 2002, we recorded amortization costs related to equity issued to studios of $0.7 million compared to amortization costs of $0.6 million for the three months ended September 30, 2001. Our obligation to issue additional shares to these studios upon dilution ceased immediately prior to our initial public offering. We expect amortization of intangible assets related to equity issued to studios to remain relatively constant at approximately $0.7 million per quarter for the next five quarters.

Postage and packaging costs . Our postage and packaging costs for the three months ended September 30, 2002 was $8.3 million, representing a 152% increase from our postage and packaging costs of $3.3 million for the three months ended September 30, 2001. This increase was attributable primarily to a 146% increase in the number of DVDs mailed to our paying subscribers, coupled with the rate for first-class postage increasing to $0.37 from $0.34 on June 30, 2002, partially offset by a reduction in per unit packaging costs.

Cost of sales revenue . Cost of sales revenues for the three months ended September 30, 2002 was $0.3 million, an increase from our cost of sales revenue of $0.2 million for the three months ended September 30, 2001. This increase was attributable to an increase in sales of used DVDs.

Gross profit . Our gross profit increased from $9.0 million for the three months ended September 30, 2001 to $19.2 million for the three months ended September 30, 2002, representing 47.9% and 47.2% of revenues, respectively. This slight decrease in our gross profit percentage is attributable primarily to an increase in our postage and packaging costs as a percentage of revenues, associated with the first-class postal rate increase, and a modest increase in disc usage by our subscribers, partially offset by a decrease in our content costs (such as revenue sharing costs, DVD amortization costs, and amortization of intangibles related to equity issued to studios), as a percentage of revenues. Content costs decreased as a percentage of revenues primarily due to the amortization of intangibles related to equity issued to studios being a fixed cost not correlated to our revenues or subscribers. Disc usage increased slightly primarily due to the modest increase in the disc usage by subscribers in those areas serviced by our regional distribution centers, also referred to as metropolitan shipping centers. We expect to see a similar modest increase in disc usage in those areas to be serviced by the additional metropolitan shipping centers we anticipate opening by the end of 2003. The Company expects gross profit percentages for the fourth quarter of fiscal 2002 to be in the range of 47% and 48%.

Operating Expenses

Fulfillment . Fulfillment expense represents those expenses incurred in operating and staffing our distribution and customer service centers, including costs attributable to receiving, inspecting and warehousing our library. Fulfillment expense also includes credit card fees and other collection related expenses. Fulfillment expense for the three months ended September 30, 2002 was $4.9 million, representing a 50% increase from our fulfillment expense of $3.3 million for the three months ended September 30, 2001. This increase was attributable primarily to an increase in the overall volume of the activities of our fulfillment operations and an increase in credit card fees. The Company currently operates eleven metropolitan shipping centers, in ten separate locations, throughout the United States and recently announced plans to open approximately fourteen additional metropolitan shipping centers in the U.S. by the end of 2003. The opening of these additional metropolitan distribution centers is not anticipated to have a material impact on fulfillment expense because the expense associated with the metropolitan shipping centers will be offset partially by reductions in the fulfillment expense of our existing metropolitan shipping centers and our primary distribution center located in San Jose, California As a percentage of revenues, fulfillment expense decreased substantially from 17.4% for the three months ended September 30, 2001 to 12.0% for the three months ended September 30, 2002 due primarily to a combination of an increasing revenue base and substantial improvements in our fulfillment productivity due to our continuous efforts to refine and streamline our fulfillment operations. The rate of improvement in our fulfillment productivity may decrease in future periods as we reach diminishing marginal returns on the refinements and streamlining efforts to our operations.

Technology and development . Technology and development expense consists of payroll and related expenses we incur related to testing, maintaining and modifying our Web site, CineMatch technology, telecommunications systems and infrastructure and other internal-use software systems. Technology and development expense also includes depreciation of the computer hardware and software we use to run our Web site and store our data. Technology and development expense for the three months ended September 30, 2002 was $4.0 million, representing an 11% decrease from our technology and development expense of $4.5 million for the three months ended September 30, 2001. This decrease was caused primarily by decreases in personnel costs as a result of employees terminated as a part of our restructuring during the three months ended September 30, 2001. As a percentage of revenues, technology and development expense decreased from 23.6% for the three months ended September 30, 2001 to 9.7% for the three months ended September 30, 2002 due primarily to an increase in revenues.

Marketing . Marketing expense consists of marketing, promotional and program expenditures, costs related to free trial periods and marketing staff. We obtain a large portion of our new subscribers through incentive-based marketing programs with third parties and consequently our marketing program expenditures fluctuate with the number of new subscribers acquired. The costs related to free trial periods includes revenue sharing costs, postage and packaging costs, library amortization costs and intangible amortization costs. Marketing expense for the three months ended September 30, 2002 was $9.3 million, representing a 170% increase from our marketing expense of $3.4 million for the three months ended September 30, 2001. This increase was attributable primarily to a 159% increase in the number of new trial subscribers for the three months ended September 30, 2002 compared to the three months ended September 30, 2001 coupled with a 4.3% increase in the marketing cost per acquired subscriber increasing from $32.19 to $33.57. As a percentage of revenues, marketing expenses increased from 18.2% for the three months ended September 30, 2001 to 22.8% for the three months ended September 30, 2002 due primarily to new trial subscriber growth outstripping growth in average paying subscribers. We expect the cost per acquired subscriber to increase for the fourth quarters of fiscal 2002 due to increases in incentive based marketing programs. Competition, from sources such as Blockbuster and Walmart's on-line affiliate Walmart.com, may impact our business and cause us to increase our marketing expenditures.

General and administrative . General and administrative expense consists of payroll and related expenses for executive, finance, content acquisition and administrative personnel, as well as recruiting, professional fees and other general corporate expenses. General and administrative expense for the three months ended September 30, 2002 was $1.9 million, representing a 86% increase from our general and administrative expense of $1.0 million for the three months ended September 30, 2001. This increase was attributable primarily to an increase in the number of personnel to support our growing subscriber base as well as increased directors and officers insurance and property insurance costs and additional professional fees caused by public company filing requirements. As a percentage of revenues, general and administrative expenses decreased from 5.3% for the three months ended September 30, 2001 to 4.6% for the three months ended September 30, 2002 due primarily to an increase in revenues.

Stock-based compensation . The Company's stock-based compensation expense relates to fixed award accounting for option grants with exercise prices below the deemed fair market value of our common stock and variable award accounting for options that were repriced in August 2001. Stock-based compensation expense for the three months ended September 30, 2002 was $1.5 million, consisting of $2.2 million related to fixed award accounting and a credit of $0.7 million related to variable award accounting, representing a 20% increase from our stock-based compensation expense of $1.2 million for the three months ended September 30, 2001 which all related to fixed award accounting.

The increase in the fixed award compensation expense was attributable to the issuance of options in 2002 with exercise prices below the deemed fair value of our common stock. Since our initial public offering, there is no longer any difference between fair market value and the exercise price for new option grants and as a result no new deferred stock-based compensation has or is expected to arise from new awards. Consequently, we expect our future stock-based compensation expense will relate to existing awards.

The decrease/credit in stock-based compensation expense related to variable award accounting was due to our stock price declining during the three months ended September 30, 2002.

In August 2001, we offered our employees and directors the right to exchange certain stock options. We exchanged options to purchase approximately 900,000 shares of common stock with varying exercise prices in exchange for options to purchase approximately 900,000 shares of common stock with an exercise price of $3.00 per share. As of September 30, 2002, approximately 700,000 of these awards were outstanding.

The stock option exchange resulted in variable award accounting treatment for all of the exchanged options. Variable award accounting will continue until all options subject to variable accounting are exercised, cancelled or expire. Once these awards are exercised, cancelled or expire they will no longer be subject to variable award accounting. Variable accounting treatment will result in unpredictable and potentially significant charges or credits to our operating expenses from fluctuations in the market price of our common stock. For each hypothetical one-dollar increase or decrease in the fair value of our common stock, we will record deferred compensation in an amount equal to the number of shares underlying the variable awards multiplied by the one-dollar change. However, to the extent these variable awards are not fully vested, our stock compensation expense will be less than the amount we record as deferred compensation.

For example, as of September 30, 2002, if the market value of our common stock was different by $1.00, our deferred stock-based compensation would change by approximately $700,000 and our stock-based compensation expense would be affected by approximately $300,000. Once these variable awards become fully vested, our stock based compensation will be affected on a dollar-for-dollar basis and a change in our stock price will directly impact the amount we record as stock-based compensation in an amount equal to the number of shares underlying the variable awards outstanding multiplied by the change in the market value of our common stock. For example, assuming all of the approximately 700,000 variable awards are fully vested and outstanding and assuming an increase or decrease in the market value of our common stock of $1.00 in a quarter, our stock-based compensation expense or credit related to the variable awards for that quarter would be $700,000. As of September 30, 2002, most of these variable awards were not fully vested and had a variety of final vesting dates over the next two years.

Interest and Other Income (Expense), Net

Interest and other income (expense) net, consists primarily of interest earned on our cash and cash equivalents and short-term investments offset by interest expense related to interest-bearing obligations. Interest and other income, net was $0.6 million for the three months ended September 30, 2002, compared to interest and other expense, net of ($0.5 million) for the three months ended September 30, 2001. This change from expense to income was attributable primarily to interest income on the investment of net proceeds from our initial public offering in May 2002 and a reduction in interest-bearing obligations, some of which were repaid following our initial public offering.

Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001

Revenues

Subscription revenues . Our subscription revenues for the nine months ended September 30, 2002 were $105.8 million, representing a 100% increase from our subscription revenues of $52.9 million for the nine months ended September 30, 2001. The increase in total subscription revenues was caused by a 96% increase in the number of average paying subscribers for the nine months ended September 30, 2001 of 282,000 to 554,000 for the nine months ended September 30, 2002. We believe the number of subscribers increased for several reasons including the continuing consumer adoption of DVD players, our increasingly effective marketing programs and the opening of our metropolitan shipping centers during the nine months ended September 30, 2002.

Sales revenues . Our sales revenues for the nine months ended September 30, 2002 were $1.8 million, representing a 27% increase from our sales revenues of $1.4 million for the nine months ended September 30, 2001. This increase was attributable to increases in our sale of used DVDs to resellers.

Cost of Revenues

Cost of subscription revenues . Cost of subscription revenues for the nine months ended September 30, 2002 was $53.8 million, representing a 39% increase from our cost of subscription revenues of $38.6 million for the nine months ended September 30, 2001. This increase was attributable primarily to the net effect of the following:

> *Revenue sharing costs* . Our revenue sharing costs for the nine months ended September 30, 2002 were $21.1 million, representing a 154% increase from our revenue sharing cost of $8.3 million for the nine months ended September 30, 2001. This increase was due primarily to a 96% increase in average number of paying subscribers between 2001 and 2002, coupled with an increase in the mix between titles delivered to subscribers that were subject to revenue sharing versus titles that were not subject to revenue sharing. As a percentage of subscription revenues, our revenue sharing costs increased from 15.4% during the nine months ended September 30, 2001 to 19.7% during the nine months ended September 30, 2002.
>
> *DVD amortization costs* . Our DVD amortization costs for the nine months ended September 30, 2002 were $10.3 million, representing a 43% decrease from our DVD amortization costs of $18.0 million for the nine months ended September 30, 2001. The decrease was attributable to an increase in amortization in the nine months ended September 30, 2001, which was caused by the change in the estimated life of our DVD library from three years to one year effective January 1, 2001, offset by an increase in amortization related to increased acquisitions for our library.
>
> *Amortization of intangible assets related to equity issued to studios* . For the nine months ended September 30, 2002, we recorded amortization costs of $2.0 million relating to equity issued to studios, representing a 50% increase from our amortization costs of $1.3 million for the nine months ended September 30, 2001. The increase in amortization was attributable to increases in intangible assets caused by our obligation to issue additional shares to these studios upon dilution, which ceased immediately prior to our initial public offering. We expect the amortization of intangible assets related to equity issued to studios to remain relatively constant at approximately $0.7 million per quarter for the next five quarters.
>
> *Postage and packaging costs* . Our postage and packaging costs for the nine months ended September 30, 2002 was $20.4 million, representing an 85% increase from our postage and packaging costs of $11.0 million for the nine months ended September 30, 2001. This increase was attributable primarily to a 107% increase in the number of DVDs mailed to our subscribers, coupled with the rate for first-class postage increasing to $0.37 from $0.34 on June 30, 2002, partially offset by a reduction in per unit packaging costs.

Cost of sales revenue . Cost of sales revenues for the nine months ended September 30, 2002 were $0.9 million, representing a 52% increase from our cost of sales revenue of $0.6 million for the nine months ended September 30, 2001. This increase was attributable primarily to an increase in sales of used DVDs.

Gross profit . Our gross profit increased from $15.1 million for the nine months ended September 30, 2001 to $52.9 million for the nine months ended September 30, 2002, representing 27.7% and 49.1% of revenues, respectively. Our gross profit percentages increased primarily as a result of the growth in our subscription revenues and a decrease in our direct incremental costs of providing those subscription services, coupled with the 43% reduction in DVD amortization costs in 2002 as compared to 2001.

Operating Expenses

Fulfillment . Fulfillment expense for the nine months ended September 30, 2002 was $13.9 million, representing a 13% increase from our fulfillment expense of $10.5 million for the nine months ended September 30, 2001. This increase was attributable primarily to an increase in the overall volume of the activities of our fulfillment operations and an increase in credit card fees As a percentage of revenues, fulfillment expense decreased substantially from 19.3% for the nine months ended September 30, 2001 to 12.9% for the nine months ended September 30, 2002 due primarily to a combination of an increasing revenue base and substantial improvements in our fulfillment productivity due to our continuous efforts to refine and streamline our fulfillment operations, and a reduction in credit cards fees as a percentage of revenues. The rate of improvement in our fulfillment productivity may decrease in future periods as we reach diminishing marginal returns on the refinements and streamlining efforts to our operations.

Technology and development . Technology and development expense for the nine months ended September 30, 2002 was $10.7 million, representing a 28% decrease from our technology and development expense of $14.8 million for the nine months ended September 30, 2001. This decrease was caused primarily by decreases in personnel costs as a result of employees terminated as part of our restructuring during the nine months ended September 30, 2001. As a percentage of revenues, technology and development expenses decreased from 27.3% for the nine months ended September 30, 2001 to 9.9% for the nine months ended September 30, 2002 due primarily to an increase in revenues and a decrease in the absolute dollar amount we spent on technology and development.

Marketing . Marketing expense for the nine months ended September 30, 2002 was $25.3 million, representing a 78% increase from our marketing expense of $14.2 million for the nine months ended September 30, 2001. This increase was attributable primarily to a 143% increase in the number of new trial subscribers for the nine months ended September 30, 2002 compared to the nine months ended September 30, 2001 offset by decreases in the marketing cost per acquired subscriber from $41.85 to $30.66. The decrease in the cost per acquired subscriber was due primarily to costs related to free trials and marketing staff and other costs increasing only moderately in absolute dollars but declining 27% on a per acquired subscriber basis due to the large increase in new trial subscribers. As a percentage of revenues, marketing expenses decreased from 26.1% for the nine months ended September 30, 2001 to 23.5% for the nine months ended September 30, 2002 due primarily to an increase in revenues. We expect the cost per acquired subscriber to increase for the fourth quarter of fiscal 2002 due to increases in incentive based marketing programs. Competition, from sources such as Blockbuster and Walmart’s on-line affiliate, Walmart.com, may impact our business and cause us to increase our marketing expenditures.

General and administrative . General and administrative expense for the nine months ended September 30, 2002 was $4.8 million, representing a 36% increase from our general and administrative expense of $3.5 million for the nine months ended September 30, 2001. This increase was attributable primarily to an increase in the number of personnel to support our increasing subscriber base as well as increased directors and officers insurance and property insurance costs and additional professional fees caused by public company filing requirements. As a percentage of revenues, general and administrative expenses decreased from 6.5% for the nine months ended September 30, 2001 to 4.5% for the nine months ended September 30, 2002 due primarily to an increase in revenues.

Stock-based compensation . Stock-based compensation expense for the nine months ended September 30, 2002 was $7.1 million, consisting of $5.7 million related to fixed award accounting and $1.4 million related to variable award accounting, representing a 50% increase from our stock-based compensation expense of $4.7 million for the nine months ended September 30, 2001 which all related to fixed award accounting.

The increase in the fixed award compensation expense was attributable to the issuance of options in 2002 with exercise prices below the deemed fair value of our common stock. Since our initial public offering, there is no longer any difference between fair market value and the exercise price for new option grants and as a result no new deferred stock-based compensation has or is expected to arise from new awards. Consequently, we expect our future stock-based compensation expense will relate to existing awards.

The increase in stock-based compensation expense related to variable award accounting was due to our stock price increasing during the nine months ended September 30, 2002.

Interest and Other Income (Expense), Net

Interest and other expense, net was ($10.8 million) for the nine months ended September 30, 2002, representing a substantial increase from our interest and other expense, net of ($0.8 million) for the nine months ended September 30, 2001. This increase was attributable primarily to a non-cash one-time charge of $10.7 million associated with our early repayment of all outstanding indebtedness under our subordinated promissory notes related to the acceleration of the accretion of the unamortized discount.

Liquidity and Capital Resources

Since inception, we have financed our activities primarily through a series of private placements of convertible preferred stock, subordinated promissory notes and our initial public offering. As of September 30, 2002, we had cash and cash equivalents of $54.3 million and short-term investments of $43.2 million.

Net cash used in operating activities was $1.5 million for the nine months ended September 30, 2001. Net cash provided by operating activities was $25.7 million for the nine months ended September 30, 2002. The $27.2 million improvement in cash from operations between the nine months ended September 30, 2001 and September 30, 2002 was driven primarily by a $14.5 million reduction in net loss due to revenues growing at a much faster rate than operating expenses, offset by a $7.1 million reduction in depreciation and amortization, a $2.4 million increase in non-cash stock-based compensation, a $10.8 million increase in non-cash interest expense, and an $8.1 million increase in operating assets and liabilities, offset by $1.5 million gain on disposal of used DVDs.

Net cash used in investing activities increased from $9.2 million for the nine months ended September 30, 2001 to $57.2 million for the nine months ended September 30, 2002. This increase was attributable primarily to a $42.6 million purchase of short-term investments with a portion of our initial public offering proceeds and a $9.5 million increase in the costs related to the acquisition of titles for our DVD library. While DVD acquisition expenditures are classified as cash flows from investing activities you may wish to consider these together with cash flows from operating activities.

Net cash provided by financing activities increased to $69.7 million for the nine months ended September 30, 2002 from net cash provided by financing activities of $10 million for the nine months ended September 30, 2001. The net cash provided by financing activities for the nine months ended September 30, 2002 was attributable primarily to proceeds from the sale of our common stock in our initial public offering that raised net proceeds of $85.9 million, partially offset by the repayment of $14.2 million on our subordinated notes payable and $2.7 million on our other notes payable and capital lease obligations.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 143, *Accounting for Asset Retirement Obligations* . This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement applies to all entities. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. As used in this Statement, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. This Statement amends FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies.* The adoption of this standard will not impact our financial statements.

In July 2002, the Financial Accounting Standards Board (FASB) issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities.* The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. Previous accounting guidance was provided by EITF Issue No. 94-3, “Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).” Statement 146 replaces Issue 94-3. The adoption of this standard will not impact our financial statements.

Item 3. Qualitative and Quantitative Disclosures about Market Risk

The primary objective of our investment activities is to preserve principal, while at the same time maximizing income we receive from investments without significantly increased risk. Some of the securities we invest in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the value of our investment will decline. To minimize this risk in the future, we intend to maintain our portfolio of cash equivalents and investments in a variety of securities, including commercial paper, money market funds, government and non-government debt securities and certificates of deposit with maturities of less than thirteen months. In general, money market funds are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of a date within 90 days of the filing date of this Quarterly Report on Form 10-Q, the Company’s principal executive officer and principal financial officer have concluded that the Company’s disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (the “Exchange Act”)) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) *Changes in internal controls .* There were no significant changes in the Company’s internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Table of Contents

PART II. OTHER INFORMATION

Item 1 . Legal Proceedings

We are not a party to any material legal proceedings.

Item 2 . Changes in Securities and Use of Proceeds

(d) Use of Proceeds.

We continue to maintain approximately $42.1 million of the net proceeds from our initial public offering in short-term investments and $29.6 million in cash and cash equivalents.

Table of Contents

Item 6 . Exhibits and Reports on Form 8-K

(a) Exhibits.

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation. (16)
3.2	Amended and Restated Bylaws. (1)
4.1	Form of Common Stock Certificate. (2)
10.1	Form of Indemnification Agreement with each of the Registrant's Executive Officers and Directors. (3)
10.2	2002 Employee Stock Purchase Plan. (4)
10.3	Amended and Restated 1997 Stock Plan. (5)
10.4	2002 Stock Plan. (6)
10.5	Amended and Restated Stockholders' Rights Agreement dated July 10, 2001. (7)
10.6	Office Lease dated October 27, 2000 with BR3 Partners. (8)
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10.15	Strategic Marketing Agreement dated August 21, 2001 with Best Buy, Co., Inc.*
99.1	Certification of Chief Executive Officer and Chief Financial Officer.

(1) Incorporated by reference to Exhibit 3.4 of our registration statement on Form S-1 filed with the Securities and Exchange Commission on April 16, 2002.
(2) Incorporated by reference to Exhibit 4.1 of our registration statement on Form S-1 filed with the Securities and Exchange Commission on April 16, 2002.
(3) Incorporated by reference to Exhibit 10.1 of our registration statement on Form S-1 filed with the Securities and Exchange Commission on March 20, 2002.
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(15) Incorporated by reference to Exhibit 10.14 of our registration statement on Form S-1 filed with the Securities and Exchange Commission on May 20, 2002.
(16) Incorporated by reference to our quarterly filing on Form 10-Q filed with the Securities and Exchange Commission on August 14, 2002.

(b) Reports on Form 8-K. We did not file any current reports on Form 8-K for the quarter ended September 30, 2002.

* CONFIDENTIAL TREATMENT REQUESTED

Table of Contents

Signatures

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

		Netflix, Inc
Dated: November 11, 2002	By:	/s/ REED HASTINGS
		Reed Hastings Chief Executive Officer
Dated: November 11, 2002	By:	/s/ BARRY MCCARTHY
		Barry McCarthy Chief Financial Officer *(Principal financial and accounting officer)*

Table of Contents

CERTIFICATIONS

I, Reed Hastings, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Netflix, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 11, 2002

/s/ REED HASTINGS

Reed Hastings
Chief Executive Officer

I, Barry McCarthy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Netflix, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 11, 2002	/s/ Barry McCarthy
	Barry McCarthy Chief Financial Officer

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation. (16)
3.2	Amended and Restated Bylaws. (1)
4.1	Form of Common Stock Certificate. (2)
10.1	Form of Indemnification Agreement with each of the Registrant's Executive Officers and Directors. (3)
10.2	2002 Employee Stock Purchase Plan. (4)
10.3	Amended and Restated 1997 Stock Plan. (5)
10.4	2002 Stock Plan. (6)
10.5	Amended and Restated Stockholders' Rights Agreement dated July 10, 2001. (7)
10.6	Office Lease dated October 27, 2000 with BR3 Partners. (8)
10.7	Letter Agreement dated August 11, 1999 with Lincoln-Recp Old Oakland Opco, LLC; First Amendment to Lease Agreement dated December 3, 1999; Second Amendment to Lease Agreement dated January 4, 2000; Third Amendment to Lease Agreement dated June 12, 2001 with Joseph Scully. (9)
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* — Confidential Treatment Requested

EXHIBIT 10.14

FIRST AMENDMENT TO STRATEGIC MARKETING AGREEMENT

This First Amendment to Strategic Marketing Agreement (this "Amendment") is entered into as of June 1, 2002, (the "Effective Date") by and between Best Buy Co., Inc., Best Buy Stores, L.P. and BestBuy.com LLC (fka BestBuy.com, Inc.) with offices at 7075 Flying Cloud Drive, Eden Prairie, Minnesota 55344, ("Best Buy") and Netflix, Inc., a Delaware corporation (successor by name change to NetFlix.com, Inc.), with offices at 970 University Avenue, Los Gatos, California 95032 ("Netflix").

RECITALS

A. Best Buy and Netflix entered into that certain Strategic Marketing Agreement entered into as of August 15, 2001 (the "Agreement").

B. Best Buy and Netflix desire to amend the Agreement as set forth below

NOW THEREFORE, in consideration of the mutual promises contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

1. The parties acknowledge that Netflix has changed its name from NetFlix.com, Inc. to Netflix, Inc. As such, the defined term Netflix, shall refer to Netflix, Inc.

2. Section 1.12 of the Agreement is hereby deleted in its entirety and replaced with the following:

"Expiration Date" means the later of (i) twenty four (24) months from the Start Date or the next business day if such date falls on a weekend or holiday; or (ii) if applicable, the expiration of the Renewal Period.

3. Section 1.26 of the Agreement is hereby deleted in its entirety and replaced with the following:

"Start Date" shall mean August 15, 2001.

4. Section 1.29 of the Agreement is hereby deleted in its entirety and replaced with the following:

"Subscriber" means a customer, with a mailing address within the United States, its territories, or possessions, (who had not, before the execution of this Agreement, subscribed to Netflix's online DVD rental service) who has agreed to the terms and conditions of the Netflix service, subscribes for DVD rental service and [*]via (a) the Netflix Site through a Promotion Code provided for by this Agreement or (b) the Co-branded Site. As used in this definition, [*]shall mean that the [*]has not been [*]to or [*]or otherwise[*].

5. Best Buy acknowledges that it has received the Shares issued under Section 3.1 of the Agreement and[*]. Netflix hereby represents to Best Buy that it has not issued any additional shares of stock that would trigger any rights under Section 3.1.1 of the Agreement.

6. Section 3.2 of the Agreement is hereby deleted in its entirety and replaced with the following:

3.2 From and after the Effective Date, Netflix shall pay Best Buy[*] .

7. Section 3.3 of the Agreement is hereby deleted in its entirety and replaced with the following:

3.3 Intentionally deleted.

8. Section 3.4 of the Agreement is hereby deleted in its entirety and replaced with the following:

3.4 Netflix shall have no obligation to pay any [*]for Subscribers that become Subscribers on or after[*]. Netflix shall pay Best Buy [*] of the [*]received[*] that became a Subscriber prior to[*].

9. Section 6.1 of the Agreement is hereby deleted in its entirety and replaced with the following:

6.1 Netflix shall prepare and send Best Buy[*], to be delivered to Best Buy[*] after the Effective Date, setting forth the following:

6.1.1 The number of[*];
6.1.2 The [*]due for [*]pursuant to Section 3.2;
6.1.3 The total number of [*]as of the end of the[*];
6.1.4 The [*]received from [*]that became[*] before[*].
6.1.5 The [*]due Best Buy under Section 3.4; and
6.1.6 The cost of [*]to Best Buy during[*].

10. Section 6.2 of the Agreement is hereby deleted in its entirety and replaced with the following:

6.2 A [*]of the [*]payment of the [*]due Best Buy [*]shall [*]the foregoing statement [*]and be made as follows:
[*]following the end of the calendar month following the date [*]

following the end of the calendar month following the date[*];
following the end of the calendar month following the date [*]and
[*]following the end of the calendar month following the date[*].

11. Section 6.4 of the Agreement is hereby deleted in its entirety and replaced with the following:

6.4 Best Buy shall not be required [*]paid in accordance with Section 3.2 and/or 3.4 after [*]days from the date the person became[*], unless the person became a [*]through a [*]that demonstrates a [*]from the first [*]to the second[*] of at least [*] percentage points less than the [*]for the same period for [*]Best Buy promotions, in which case the deadline for [*]from Best Buy for such [*]with respect to that particular [*]shall extend to[*] days after the date the person became a[*]. For purposes of this Section, "[*]" means, with respect to a particular [*]or the [*]Best Buy promotions, as applicable, the [*]which is calculated by taking the number of [*] who [*]and are [*]for a month and dividing by the number of [*]who[*] and were [*]for the previous month. As used in this definition, "[*]" shall mean that the [*]has not been [*]to or [*]by the customer or otherwise [*]to Netflix by the[*].

12. Section 7.5 is hereby deleted in its entirety and replaced with the following:

7.5 This Agreement shall automatically renew for an additional [*](the "Renewal Period") but only if Best Buy shall have [*]at least [*] during the period from[*].

13. Except as expressly modified by this Amendment, all of the terms and conditions contained in the Agreement are hereby affirmed and ratified in all respects.

(Signatures on next page)

IN WITNESS WHEREOF , the parties hereto have executed this Amendment as of the Effective Date.

BEST BUY CO., INC.		**NETFLIX, INC.**	
By:	/s/ Scott Young	By:	/s/ Leslie Kilgore
Name:	Scott Young	Name:	Leslie Kilgore
Title:	VP Business Development	Title:	VP Marketing
Date:	5/23/02	Date:	5/28/02
BEST BUY STORES, L.P.		**BESTBUY.COM LLC**	
By:	BBC Property Co., its general partner		
By:	/s/ Joseph Joyce	By:	/s/
Name:	Joseph Joyce	Name:	
Title:	Senior VP	Title:	
Date:	5/24/02	Date:	

EXHIBIT 10.15

STRATEGIC MARKETING AGREEMENT

THIS STRATEGIC MARKETING AGREEMENT is entered into by and between **Best Buy Co., Inc.** , on behalf of itself and its designated subsidiaries and affiliates, including Best Buy Stores, L.P. and BestBuy.com, Inc., with offices at 7075 Flying Cloud Drive, Eden Prairie, Minnesota 55344, ("Best Buy") and **NetFlix.com Inc.** , a Delaware corporation, with offices at 970 University Avenue, Los Gatos, California 95032 ("NetFlix").

NOW, THEREFORE, in consideration of the mutual promises contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

1. DEFINITIONS

1.1. "Agreement" refers to this Strategic Marketing Agreement, all exhibits, attachments, addenda, and schedules referred to herein, as it or they may be amended from time to time.

1.2. "Best Buy Site" means the sites operated and controlled by Best Buy, located on the world wide web portion of the internet and identified by the URLs www.bestbuy.com, www.samgoody.com, www.suncoast.com, www.mediaplay.com, www.oncue.com, and such other internet sites that are hosted on file servers operated by or on behalf of Best Buy or operated under Best Buy's trademarks and trade name, whether or not "co-branded" with the trademarks or trade names of other entities, regardless of whether such sites are accessed directly through a personal computer or through a kiosk or terminal located in a Best Buy retail store, or via devices such as (but not limited to) mobile phones, web devices, portable digital devices, wireless devices, etc. The Best Buy Site shall exclude the Co-branded Site.

1.3. "Best Buy's [*]" means[*], directly or indirectly, from or regarding (a) Best Buy's [*]are not [*]and (b) Best Buy's [*]are[*], but only for that [*]which is received from such customers because of [*]which are not related to this Agreement. Best Buy's[*] also includes all[*] created or derived from the above, including but not limited to [*]; and any[*].

1.4. "Buy Button" means a prominently displayed text, button, icon, or other image that links a consumer to a corresponding movie search result page (or other mutually agreed upon page) within the Best Buy Site.

1.5. "Change of Control" means

1.5.1. The consummation of the sale of all or substantially all of the assets of NetFlix;

1.5.2. The consummation of a reorganization, merger, or consolidation to which NetFlix is a party, if the stockholders of NetFlix immediately prior thereto (excluding any person participating in the Change of Control transaction) own less than a majority of NetFlix' voting power immediately thereafter;

1.5.3. The acquisition by any person or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under such Act) of more than a majority of the voting power of those classes of voting stock of NetFlix entitled to vote for the election of directors; or

1.5.4. Any other transaction, whether through change in directorships or otherwise, which has the purpose or effect of substantially changing the persons entitled to direct the affairs of NetFlix.

1.6. "Co-branded Site" means the web site which is customized for Subscribers, and is more particularly described in Exhibit A.

1.7. "Competitors" means[*]

1.8. "Confidential Information" means any information provided by the disclosing party to the receiving party or any third party acting on behalf of such receiving party and relating in any way to the subject matter of this Agreement, whether furnished before or after the Start Date and regardless of the manner in which furnished. Confidential Information includes but is not limited to: (a) all information related to sales of products, such as raw data, reports, and compilations of such data or information (including, but not limited to, information provided pursuant to Section 2.3); (b) information relating to the services performed under this Agreement; (c) work papers, analyses, compilations, projections, and statistical data; (d) product cost and or sale information or data; (e) identities of any current or pending or future vendors or planned products and services to be offered or withdrawn; (f) planned and future promotions and grand opening dates; (g) business plans and forecasts; (h) Best Buy's [*]; (i) NetFlix' [*]; and (j) any documents or other items marked "Confidential" or specifically communicated as "Confidential". Confidential Information does not include any information which: (1) is already known to the receiving party; or (2) becomes available to the receiving party from other sources which the receiving party reasonably believes not to be bound by any obligation of confidentiality, directly or indirectly, to the disclosing party; or (3) is independently developed by the receiving party; or (4) is now or hereafter available to the public through no breach of this Agreement by the receiving party or its employees or agents; or (5) is disclosed by the receiving party in accordance with the terms of a prior written approval of the disclosing party; or (6) [*].

1.9. "[*]" means the [*]in a calendar week that [*]the Co-branded Site or[*] the Co-branded Site for[*], whether due to any [*]of the Co-branded Site or its related technology, including any proprietary or third-party[*].

1.10. "[*]" refers to Best Buy's[*] which allows [*]to [*]for certain [*]and which [*]the necessary [*]information to such [*].

1.11. "Event of Default" means any one of the following:

1.11.1. A party breaches any material provision or any warranty of this Agreement; or

1.11.2. A party becomes insolvent or is adjudged a bankrupt or makes an assignment for the benefit of creditors; or

1.11.3. A receiver of any property of a party is appointed in any action, suit, or proceeding by or against the party and is not removed within 90 days after such appointment.

1.12. "Expiration Date" means the latter of (i) date twenty-four (24) months from the Start Date or the next business day if such date falls on a weekend or a holiday; or (ii) the expiration of the Renewal Period.

1.13. "[*]" means the[*]

1.14. “Impression” means an instance where a consumer in a retail venue or a unique user on the internet is exposed to a specified image.

1.15. “Insert” means Best Buy’s free standing newspaper advertising insert, currently distributed weekly.

1.16. “Link” means an embedded icon, object, graphic or text within a web page that consists of a hypertext pointer to the URL address of a web page.

1.17. “[*]” means the [*]due to[*]. shall normally be between the hours of [*] and [*]shall not exceed [*] minutes in a[*] and (b) [*]per [*].

1.18. “Movie Display Page” means a page on the NetFlix Site that features one specific movie title and which contains information about the movie including but not limited to the cast, credits, synopsis, and reviews.

1.19. “NetFlix’ [*]” means [*] received or extracted, directly or indirectly, from or regarding NetFlix [*]who are not [*]and all[*] created or derived from the above, including but not limited to [*]and[*], and any[*] of such data.

1.20. “NetFlix Site” means the site operated by NetFlix, located on the world wide web portion of the internet, the initial, top level display of which is identified by the following URL: <www.netflix.com>, or such other internet site operated under NetFlix’s trademarks and trade name. NetFlix Site shall not include the Co-branded Site.

1.21. “Promotional Code” means the numbers and/or letters that are used by NetFlix to determine which promotion a Subscriber is signing up under and also to track Subscriber activity.

1.22. “Renewal Period” shall have the meaning as defined in Section 7.5.

1.23. “Scheduled Time” means 10,080 minutes less [*]for the [*]week.

1.24. “Single Use Code” means a code that can only be used one time by one individual.

1.25. “Shares” means NetFlix’ Series F nonvoting, convertible, preferred stock.

1.26. “Start Date” shall mean the execution date of this Agreement.

1.27. “Sticker” means the promotional sticker that is (i) [*] (ii) agreed upon by the parties and shown within the attached, and incorporated herein, Attachment A1. All Stickers shall contain a Promotional Code.

1.28. “Studios” means the major Hollywood motion picture studios of[*].

1.29. “[*].

1.30. “Subscriber Information” means the[*] identity of Subscribers.

1.31. “Term” means the period of time between the Start Date and the earlier of the Expiration Date or Termination Date.

1.32. “Termination Date” means the effective date of any termination of this Agreement other than the Expiration Date.

1.33. [*]

1.34. [*]

2. BEST BUY'S OBLIGATIONS

2.1. Best Buy shall [*]to promote and market the Co-branded Site as provided in Exhibit C attached hereto and incorporated herein by reference.

2.2. Best Buy shall [*]its in-store, corporate, and online customer care personnel in order to enable them to [*]customer inquiries about [*].

2.3. Each month during the term hereof, as such as may be extended, Best Buy shall [*]to furnish NetFlix with[*]), and [*]sold the prior [*]by [*]together with its [*]for each of the[*].

2.4. Using a file provided monthly by NetFlix, Best Buy will, within [*]days of its receipt of such file, identify for NetFlix those individuals who have signed up for[*] but who were either (a) never [*]or (b) are no longer [*](which in such case Best Buy shall also provide their[*]). Best Buy agrees that NetFlix may contact via email those individuals identified by Best Buy as[*]and inform them that [*]is being increased to [*]and further inform them that[*]. In this email NetFlix will identify a contact at Best Buy, to be provided by Best Buy, to whom any questions on [*]can be directed. Best Buy shall determine in its [*]what constitutes[*]and whether such [*]is considered [*]for purposes of this Agreement.

3. NETFLIX' OBLIGATIONS

3.1. Upon execution of this Agreement, NetFlix shall issue to Best Buy [*]Shares. Upon Best Buy's request, NetFlix agrees to discuss in good faith, from time to time, the purchase of additional shares by Best Buy.

3.1.1. In the event, and each time, that NetFlix, prior to (1) the effective date of NetFlix' registration statement filed under the Securities Act of 1933 in connection with an initial public offering of NetFlix shares; (2) a Change of Control; or (3) becoming subject to the reporting requirements of the Securities and Exchange Act of 1934, issues additional shares of stock during the Term as part of a financing in which a venture capital fund, investment bank, or mutual fund is the largest investor, then Section 3.1 and Section 3.3 shall automatically be amended so that the number of Shares issued and issuable to Best Buy under Section 3.1 and Section 3.3 immediately prior to such financing shall be increased by multiplying such Shares by a fraction, (x) the numerator of which shall be the number of fully diluted common stock equivalent shares outstanding immediately after such financing, and (y) the denominator of which shall be the number of fully diluted common stock equivalent shares outstanding immediately prior to such financing. This Section 3.1.1 and the obligations of NetFlix within it shall terminate immediately in the event that prior to such time this Agreement shall have been terminated by Best Buy or Best Buy shall have materially breached its obligations hereunder.

3.1.1.1. NetFlix shall deliver the additional Shares necessary to give effect to the retroactive amendment of Sections 3.1 and 3.3 pursuant to Section 3.1.1 within 15 days of the closing of the financing triggering an amendment pursuant to Section 3.1.1.

3.2. [*]:

3.2.1. [*];

3.2.2. [*]

3.2.3. [*].

3.3. [*]:

3.3.1. [*]

3.3.2. [*].

3.4. [*].

3.5. NetFlix shall create and host the Co-branded Site as more particularly described in Exhibit A.

3.6. NetFlix shall place and maintain [*]Buy Buttons on the NetFlix Site. NetFlix will place a Buy Button next to [*] that is added to the NetFlix Site and for which a Movie Display Page is created after the Start Date. [*].

3.7. At Best Buy's request, NetFlix shall [*] no less than [*]and not more than[*] offering some promotional benefit to Subscribers[*], beginning from the Start Date. The [*]will be either stand alone [*]or be incorporated into existing[*], as the parties shall mutually agree, such as[*]. Best Buy will be responsible for creating and delivering [*]and the [*]to NetFlix subject to NetFlix's approval, not to be unreasonably withheld.

3.8. NetFlix agrees that in the event NetFlix enters into any[*] agreement with respect to promotional offers (each, a "[*]Agreement") in which NetFlix[*] to a [*](each, a "[*]") [*] which [*]to any such [*]with respect to [*]of this Agreement than [*]to Best Buy[*], then (i) NetFlix shall [*]to [*]within[*] of the effective date of such[*], (ii) Best Buy shall [*]such more [*]in writing within[*], (iii) in the event Best Buy accepts[*], Best Buy shall receive the [*]of such [*]effective the [*]such [*]became effective for such[*], and (iv) this Agreement shall be[*]. Notwithstanding the provisions of this Section 3.8, NetFlix shall be entitled to conduct[*] of [*]that may be [*]to consumers than to Subscribers, without incurring the [*]to offer such[*] Best Buy.

3.9. During the Term NetFlix shall cooperate with Best Buy to bring NetFlix's[*] system to Best Buy[*].

3.10. NetFlix shall be [*]for the creation, production, and delivery of the[*], provided, however, that Best Buy shall [*]NetFlix for its [*] incurred in supplying the [*] to Best Buy. Best Buy undertakes to[*] the usage of[*], and when Best Buy determines that the [*] of [*] would likely be [*], Best Buy will promptly so notify NetFlix in order that NetFlix may [*] Best Buy's [*] of [*]. If NetFlix [*] to [*] or [*] the [*], then Best Buy may [*]to its retail stores [*]an obligation to [*] the[*] .

3.11. NetFlix shall provide all [*]for the Co-branded Site as outlined in Exhibit B attached hereto and incorporated herein by reference.

3.12. NetFlix shall create a series of Promotional Codes which shall be placed on all Stickers and all marketing materials distributed by Best Buy. When the Promotional Code is entered into the NetFlix Site by a Subscriber, the Subscriber shall be [*]to the Co-branded Site within [*]of such entry. All [*] to Best Buy's distribution centers from [*]shall be subject to the terms of this Agreement.

3.13. NetFlix shall (a) make its various subscription services available to [*]on the same terms and conditions as other Subscribers, except that it shall [*]them[*] than the [*]for the basic “three out” subscription and (b) make its basic subscription service available to[*], as Best Buy shall[*], provided, further, that no such [*]shall be counted as [*]hereunder in [*]to Best Buy by NetFlix pursuant to[*]. NetFlix reserves the right to immediately terminate and discontinue the use of any [*]if, in NetFlix’ [*]judgment, NetFlix has reason to believe that [*]as it pertains to such code. NetFlix reserves the right to limit the type of code that it makes available to [*]to be a[*]. NetFlix reserves the right to limit the time period for which a particular code is valid. NetFlix shall give notice to Best Buy if it decides to terminate or discontinue the use of any [*]code.

3.13.1. In the event that Best Buy agrees to amend Section 3.13 to permit NetFlix to [*]the Best Buy [*]to [*]the [*]price then the terms of [*]shall apply.

3.14. NetFlix shall not directly or indirectly[*], or attempt to[*], Subscriber behavior so as to [*]Best Buy’s [*]pursuant to Sections 3.2 and 3.3 or Best Buy’s [*]pursuant to Section 3.4, including, but not limited to, [*] , or attempting to[*], Subscribers to use the NetFlix Site [*]or [*]the Co-branded Site. Best Buy acknowledges and agrees that NetFlix may pursue[*] that may have the [*]of [*]certain NetFlix subscribers (including Subscribers) to [*], but NetFlix shall in no event pursue any [*]or take [*]the intent of which is to have Subscribers become [*]subscribers [*]of[*] Co-branded Site.

4. IN-STORE SIGN UPS

4.1. The parties shall cooperate and mutually work toward allowing customers in Best Buy retail stores to become Subscribers via[*] and according to the specifications in Exhibit D attached hereto and incorporated herein by reference.

5. PHASED IMPLEMENTATION

5.1. This Agreement shall be implemented in the following phases:

5.1.1. Phase I of this Agreement shall consist of the Launch of the Co-branded Site, currently targeted for August 2001;

5.1.2. Phase II of this Agreement shall consist of the roll-out of Best Buy’s marketing activities to Best Buy retail stores during the Fall of 2001.

5.2. All dates or timeframes in this Section 5 are for reference purposes only and are not intended to bind a particular party to a particular deadline.

6. PAYMENT TERMS

6.1. [*]:

6.1.1. [*];

6.1.2. [*];

6.1.3. [*];

6.1.4. [*];

6.1.5. [*];

6.1.6. [*]

6.1.7. [*].

6.2. [*].

6.3. The parties agree to exchange documents electronically via (i) traditional Electronic Data Interchange (“EDI”); or (ii) Web-Based Electronic Commerce (“EC”).

6.4. [*].

7. TERM; TERMINATION

7.1. This Agreement shall commence on the Start Date and shall continue until the earlier of the Expiration Date or the Termination Date.

7.2. Either party may terminate this Agreement if an Event of Default occurs with respect to the other party and such Event of Default is not cured within[*] days of written notice thereof.

7.3. Upon the[*] occurrence of an Event of Default with respect to a particular party in any [*]period, the non-defaulting party may terminate this Agreement [*]upon written notice without providing the other party the opportunity to cure such [*]Event of Default pursuant to Section 7.2.

7.4. Immediately upon written notice to NetFlix, Best Buy may terminate this Agreement if NetFlix[*].

7.5. [*].

7.6. Immediately upon written notice to NetFlix, Best Buy may [*]fulfilling its marketing obligations herein if [*]have arisen that the [*] or the Co-branded Site [*]upon any party’s[*], such that, in the[*] of Best Buy’s General Counsel:

7.6.1. Best Buy may have legal exposure that NetFlix cannot appropriately address with its indemnities hereunder;

7.6.2. Such allegations may materially harm Best Buy’s[*]; or

7.6.3. Such allegations may materially harm Best Buy’s[*], if any, with any party involved with the making of such allegation.

7.7. Immediately upon written notice to NetFlix, Best Buy may [*] on a [*], if the [*](i) [*] given to NetFlix or Best Buy for the[*]; or (ii) alleges that[*] was given to NetFlix or Best Buy for the[*]of[*] to the [*]; or (iii) demands that NetFlix or Best Buy[*] the[*] of [*] to the [*] .

8. WARRANTIES AND REPRESENTATIONS

8.1. NetFlix hereby represents and warrants that:

8.1.1. It has the power and authority to enter into this Agreement and to perform its obligations hereunder, and, upon execution and delivery hereof, this Agreement shall constitute valid and binding obligations of NetFlix enforceable in accordance with its terms;

8.1.2. Entering into and performance of this Agreement by NetFlix does not violate, conflict with, or result in a material default under any other contract or agreement to which NetFlix is a party, or by which it is bound;

8.1.3. It has obtained, and shall maintain in full force during the Term, such federal, state and local authorizations as are necessary to perform its obligations under this Agreement and shall be in substantial compliance with all applicable laws and regulations governing such performance;

8.1.4. The Co-branded Site will [*]any United States laws, regulations or ordinances, or the rights of any[*], and will not give rise to any [*]of such[*], including, without limitation, claims of [*]or other [*]rights, violation of[*];

8.1.5. To the extent it is required to obtain rights, licenses, permissions, clearances, approvals and/or attribution information necessary in connection with the performance of this Agreement, it has done and will continue to do so accurately and completely, and shall incorporate where applicable all necessary credit and/or attribution information;

8.1.6. It will comply with all applicable laws (both from the United States as well as the rest of the world where applicable) concerning data privacy, as well as the privacy policy displayed on the Co-branded Site, as may be amended from time to time;

8.1.7. While on Best Buy's premises, NetFlix and persons employed or conducting business with NetFlix will comply with all policies and procedures promulgated by Best Buy as to Best Buy's premises;

8.1.8. The[*]and[*]on the [*]Site shall be[*]with the [*]for sale on the [*]or in [*]; and

8.1.9. It has, as of the Start Date, removed all [*]on the NetFlix Site [*].

8.2. Best Buy hereby represents and warrants that:

8.2.1. Best Buy has the power and authority to enter into this Agreement and to perform its obligations hereunder, and, upon execution and delivery hereof, this Agreement shall constitute the valid and binding obligations of Best Buy enforceable in accordance with its terms.

8.2.2. Entering into and performance of this Agreement by Best Buy does not violate, conflict with, or result in a material default under any other contract or agreement to which Best Buy is a party, or by which it is bound;

8.2.3. It will comply with all applicable laws (both from the United States as well as the rest of the world where applicable) concerning data privacy, as well as the privacy policy displayed on the Co-branded Site, as may be amended from time to time;

9. ASSIGNMENT

9.1. NetFlix hereby assigns Best Buy all rights NetFlix has to[*] on[*]. Best Buy may only assign such rights to[*].

10. TRADEMARKS

10.1. Best Buy hereby grants to NetFlix a limited, non-exclusive, royalty free license to use, exhibit, reproduce, communicate, publicly perform, and transmit Best Buy's trademarks and logos in the Co-branded Site and on the NetFlix Site under the terms of this Agreement, provided that all such uses will comply with any written branding guidelines provided to NetFlix as may be amended from time to time.

10.2. NetFlix hereby grants to Best Buy a limited, non-exclusive, royalty-free license to use, exhibit, reproduce, communicate, publicly perform and transmit the NetFlix trademarks, logos, and any other content provided to Best Buy by NetFlix as reasonably necessary for Best Buy to satisfy its marketing obligations hereunder, including, but not limited to, use on the Best Buy Site, for the creation of one or more Links to the Co-branded Site, for promotional materials, and for advertisements.

10.2.1. As a condition of this license, all Best Buy uses of NetFlix' trademarks, logos and other content provided by NetFlix to Best Buy shall be in accordance with the graphic standards and depiction requirements of NetFlix, as may be amended from time to time and as communicated in writing to Best Buy.

10.3. All licenses granted pursuant to this Agreement shall terminate upon termination of this Agreement, are non-assignable, and may not be sublicensed. However, Best Buy may sublicense or assign such licenses to its subsidiaries and affiliates.

10.4. Except as expressly provided herein, no property, license, permission or interest of any kind in or to the use of any trademark, trade name, color combination, insignia or device owned or used by a party is or is intended to be given or transferred to or acquired by the other party by the execution, performance or nonperformance of this Agreement or any part hereof. Each party agrees that it will in no way contest or deny the validity of, or the right or title of the other party in or to such trademark, trade name, color combination, insignia or device, by reason of this Agreement, and will not encourage or assist others directly or indirectly to do so, during the lifetime of this Agreement and thereafter. In addition, neither party will utilize any such trademark, trade name, color combination, insignia or device in any manner that would diminish its value or harm the reputation of the other party.

11. INDEMNIFICATION BY NETFLIX

11.1. NetFlix agrees to indemnify, hold harmless and defend Best Buy, its officers, directors, employees, agents, affiliates, successors and assigns against any and all claims, counterclaims, suits, demands, actions, causes of action, damages, setoffs, liens, attachments, debts, expenses, judgments, or other liabilities of whatever kind or nature as they are incurred (including but not limited to cost of defense, settlement, and reasonable attorneys' fees), arising from or out of or in connection with any actual or alleged:

11.1.1. Breach of this Agreement by NetFlix, including the representations warranties set forth in Section 8.1;

11.1.2. Violation of any law, rule, regulation, or authority by NetFlix in connection with the performance of this Agreement;

11.1.3. Negligent, reckless or intentional acts or omissions of NetFlix or its directors, officers, employees, agents, or assigns in connection with the entry into or performance of this Agreement;

11.1.4. Claim that the performance of this Agreement by Best Buy infringes the patent, copyright, trademark, trade secret or other intellectual property rights of any third party;

11.1.5. [*]; or

11.1.6. Claim of [*] in connection with any [*]

in connection with any [*].

11.2. Best Buy shall provide NetFlix with: (a) prompt written notice of such claim or action; (b)[*]; and (c) proper and full information and reasonable assistance, provided at[*], in connection with the defense or settlement of any such claim or action. Best Buy shall have the right to participate in the defense at [*]with a counsel of its choosing.

12. INDEMNIFICATION BY BEST BUY

12.1. Best Buy agrees to indemnify, hold harmless and defend NetFlix, its officers, directors, employees, agents, affiliates, successors and assigns against any and all claims, counterclaims, suits, demands, actions, causes of action, damages, setoffs, liens, attachments, debts, expenses, judgments, or other liabilities of whatever kind or nature (including but not limited to costs of defense, settlement, and reasonable attorneys' fees), arising from or out of or in connection with any claim by a third party arising from:

12.1.1. The breach of this Agreement by Best Buy, including the representations and warranties set forth in Section 8.2; or

12.1.2. The violation of any law, rule, regulation, or authority by Best Buy.

12.2. NetFlix shall provide Best Buy with: (a) prompt written notice of such claim or action; (b)[*]; and (c) proper and full information and reasonable assistance, provided at[*], in connection with the defense or settlement of any such claim or action. NetFlix shall have the right to participate in the defense at [*]with a counsel of its choosing.

13. CONFIDENTIALITY

13.1. Confidential Information is the sole property of the disclosing party and constitutes confidential trade secrets of the disclosing party, to be held by the receiving party in trust and solely for the disclosing party's benefit. The receiving party agrees that, except as required under this Agreement, it will not publish, reproduce, disclose or make any use of any such Confidential Information unless the disclosing party authorizes the publication or disclosure of such information in writing or unless the receiving party is required by law, valid court order, or government agency to disclose (but the receiving party shall first give notice to the disclosing party so that the disclosing party may seek a protective order requiring that the information and/or documents to be disclosed be used only for the purposes for which the order was issued).

13.2. The parties agree to take at least the same precautions to ensure the protection, confidentiality and security of the Confidential Information entrusted to each other and to satisfy their obligations under this Agreement as each would to protect its own confidential information but in no event less than a reasonable standard. The parties shall also limit the access to such Confidential information to only those employees having a need to know, and such employees shall be instructed concerning their obligations to maintain confidentiality. Each party shall return to the other all Confidential Information, or destroy and certify such destruction of all Confidential Information, promptly upon that party's request.

13.3. The parties acknowledge that monetary damages may not alone be a sufficient remedy for unauthorized disclosure of Confidential Information. The parties further agree that the disclosing party shall be entitled, without waiving any other rights or remedies, to such injunctive or equitable relief as may be deemed proper by a court of competent jurisdiction. Further, the parties acknowledge and agree that if there is a breach or threatened breach of the provisions of this Section 13, then the disclosing party will be irrevocably harmed and entitled to a temporary restraining order, injunction, and/or other equitable relief against the commencement or continuance of such breach without the requirement of posting a bond or proving injury as a condition of relief.

14. [*]

14.1. Except as expressly provided in this Agreement, neither party shall provide, sell, distribute, or otherwise grant access to the [*] during the Term without the prior express written permission of the other party. Notwithstanding the above, the parties may [*]to [*]for the purpose of [*] to [*] provided that the party disclosing the [*] to the [*]shall be responsible for the [*] and [*] of the[*].

14.2. Neither party shall intentionally and knowingly use [*] in any manner which would be reasonably likely to cause material harm [*]. The previous sentence does not in any way limit:

14.2.1. Either party's right to [*], or [*] its products or services to the [*] via methods which do not [*];

14.2.2. Either party's right to [*] its products and services to [*], without Best Buy's, provided further that Best Buy grants NetFlix during the Term the right to [*]all such products and services as are [*]on the [*] as of the[*].

14.3. NetFlix will provide Best Buy with any and all [*]on a [*]basis.

14.4. All [*] shall be[*]. Except as limited by this Agreement, both parties shall have [*]in all[*].

14.5. After termination of this Agreement for any reason and for a period of [*]years, neither party shall [*]to to any [*]in any manner which would allow such to that the information[*], this Agreement and the parties relationship hereunder.

14.6. In the event that NetFlix begins selling [*]through the Co-branded Site which [*]believes in [*] to [*], NetFlix will [*]such [*]from the Co-branded Site within [*].

15. RELATIONSHIP OF PARTIES

15.1. NetFlix and Best Buy understand and acknowledge that (a) each shall perform its duties hereunder as the other's independent contractor and (b) this Agreement does not create a joint venture, partnership, employment or agency relationship between NetFlix and Best Buy.

16. NOTIFICATIONS OF COMPLAINTS

16.1. Each party will [*] notify the other in writing, but in no event later than [*]of receipt, of any complaints or claims made by or through any third party or governmental or quasi-governmental agency/body regarding the obligations under this Agreement. Such reports shall contain information reasonably requested by the requesting party but shall contain at least the identity of the party making the complaint, a description of the grievance, the date of receipt by the receiving party of the complaint, the date of efforts to resolve the complaint, and the date and action taken to resolve the complaint.

17. DELEGATION OF DUTIES

17.1. Either party may hire or contract with third party service providers or other subcontractors of their choice to assist that party in fulfilling its obligations pursuant to this Agreement, provided that the party hiring or contracting with any third party service provider or other subcontractor will remain liable for the third party service provider's or subcontractor's performance and for the acts or omissions of the third party service provider or subcontractor.

17.2. Best Buy may assign this Agreement to a parent, subsidiary, or affiliated entity which is at least [*]owned by Best Buy [*]the approval of NetFlix.

17.3. Except as provided in Section 17.1 and 17.2, neither party shall delegate, or assign any of its rights or duties hereunder without the express written consent of the other party. If the requested party grants any such consent, the requesting party shall be solely responsible for the conduct of its agents, and the granting of such consent shall in no way modify or affect the obligations of the requesting party under this Agreement. Any assignment or delegation not complying with the terms of this Section shall be null and void. In the event of a proper assignment, this Agreement shall inure to the benefit of and be binding upon each of the parties and their respective successors, assigns, heirs, executors, administrators, trustees, and legal representatives.

18. PURCHASES

18.1. Neither party may purchase goods or equipment in the name of the other party. Neither party may make or incur any debts, liabilities, obligations, or contracts in the name or upon credit of the other party. NetFlix is not entitled to utilize any discount, bonus, or other marketing incentive earned by or made available to [*].

19. [*]

19.1. [*]

20. PUBLIC ANNOUNCEMENTS

20.1. NetFlix will not make any public disclosure or announcement of the existence of this Agreement or the relationship with Best Buy without the prior written consent of Best Buy. Best Buy reserves the right to approve of the contents of any such public disclosure or announcement.

21. NOTICES

21.1. All notices, requests, demands, approvals, consents, and other communications which are required or may be given hereunder shall be (1) in writing; (2) addressed to the parties as set forth below, unless a party notifies the others of a change of address (in which case the latest noticed address shall be used); and (3) deemed to have been duly given upon delivery thereof by one of the following means: (a) hand-delivered, (b) first-class mail, postage prepaid, (c) recognized overnight courier, or (d) facsimile or other electronic means provided receipt thereof is verified by the sender.

Notices To NetFlix:

NetFlix.com Inc.
Attn: VP Marketing
970 University Ave.
Los Gatos, CA 95032
408-399-3737 (fax)

With a copy to:

NetFlix.com Inc.
Attn: General Counsel
970 University Ave.
Los Gatos, CA 95032
408-399-3737 (fax)

Notices To Best Buy:

Best Buy Co., Inc.
Attn: Scott Young
7075 Flying Cloud Drive
Eden Prairie, MN 55344

With a copy to:

Best Buy Co., Inc.
Attn: General Counsel
7075 Flying Cloud Drive
Eden Prairie, MN 55344
(952) 995-7380 (fax)

22. AUDIT

22.1. Each party shall have the right to, upon [*] written notice and at [*]times during regular business hours, audit the other party to assure compliance with the terms and conditions of this Agreement. If the audit reveals that a party is not performing in [*] compliance with the terms of this Agreement, then, in addition to any other legal and equitable rights and remedies available, the party not in compliance shall [*]the other for[*]. Notwithstanding anything to the contrary herein, the parties agree that they shall not exercise their right of audit more often than, [*] nor on a date any later than [*]following the termination of this Agreement.

23. MISCELLANEOUS

23.1. Governing Law. This Agreement shall be governed, construed and interpreted in accordance with the laws of the State of New York. The parties to this Agreement consent to the jurisdiction of the state and federal courts located in Minneapolis, Minnesota.

23.2. Amendments. This Agreement may not be modified except by a writing referencing this Agreement and signed by both of the parties hereto.

23.3. Headings. The headings contained herein are for the convenience of reference only and are not of substantive effect.

23.4. [*]Except as otherwise provided herein, this Agreement shall not be [*]to [*]Best Buy and NetFlix. Best Buy shall be[*]to [*]to perform [*]covered hereby.

23.5. Severability. If any provision herein shall be deemed or declared unenforceable, invalid or void by a court of competent jurisdiction, the same shall not impair any of the other provisions contained herein which shall be enforced in accordance with their respective terms.

23.6. Entire Agreement. This writing is intended by the parties as the final and binding expression of their contract and agreement and is a complete and exclusive statement of the terms thereof and supersedes all prior negotiations, representations and agreements, including, but not limited to, the [*] and the [*]executed by NetFlix on [*]and by Best Buy on [*](both of which are hereby terminated).

23.7. Remedies; Waiver. No failure or delay by either party hereto to exercise any right, power or privilege provided hereunder or by applicable law shall operate as a waiver thereof; nor shall any single or partial exercise of any such right, power, or privilege preclude any other or future exercise thereof or the exercise of any other right, power or privilege. The remedies provided herein shall be cumulative and shall not be exclusive of any rights or remedies provided by law or equity.

23.8. Interpretation. This Agreement has been cooperatively and mutually drafted and shall not be construed or interpreted more strictly against either party.

23.9. Construction. The words "herein," "hereof," hereunder," "hereto," and other words of similar import refer to this Agreement as a whole, including the Schedules and Exhibits hereto, as the same may from time to time be amended or supplemented, and not to any particular section, subsection or clause contained in this Agreement. References herein to an Exhibit, Schedule, or Attachment refer to the appropriate Exhibit, Schedule, or Attachment to this Agreement. The word "including" shall always be interpreted as though immediately followed by the phrase "but not limited to." Whenever necessary or proper herein, the singular imports the plural or vice versa, and masculine, feminine and neuter expressions are interchangeable. Unless otherwise explicitly stated:

23.9.1. A reference in an Exhibit or Attachment to a Section refers to the appropriate numbered Section within such Exhibit or Attachment and

23.9.2. All other references to a Section refer to the appropriate numbered Section in the body of this Agreement.

23.10. No Third Party Beneficiaries. This Agreement and the rights and obligations created under it shall be binding upon and inure solely to the benefit of the parties hereto and their respective successors and permitted assigns, and nothing in this Agreement, express or implied, is intended or should be construed to confer upon any other person any right, remedy, or claim under or by virtue of this Agreement.

23.11. Survival. The following provisions shall survive termination of this Agreement, no matter how terminated: (a) Section 3.2 shall survive for a period of [*] following the earlier of the Termination Date or Expiration Date; (b) Section 3.4 shall survive for the[*], but in no event longer than [*] after the earlier of the Termination Date or Expiration Date; (c) Sections 1, 6, 10, 15, 20, 21, and 22 shall survive termination of this Agreement for a period of [*] following the earlier of the Termination Date or Expiration Date; and (d) Sections 11, 12, and 13.1 and 13.2 shall survive the termination of this Agreement[*].

23.12. [*].

IN WITNESS WHEREOF , the parties hereto have executed this Agreement as of the Start Date.

BEST BUY CO., INC.

By: /s/ Michael London

Name: Michael London

Title: GVP GM

Date: 8-17-01

NETFLIX.COM, INC.

By: /s/ J. Mitchell Lowe

Name: J. Mitchell Lowe

Title: VP Strategic Alliances

Date: 8/21/01

Best Buy Stores, L.P.

By: BBC Property Co., its general partner

By: /s/ Joseph M. Joyce

Name: Joseph M. Joyce

Title: SVP

Date: 8-15-01

BestBuy.com, Inc.

By: /s/ Scott Young

Name: Scott Young

Title: VP / GM Entertainment

Date: 8/15/01

EXHIBIT A

Co-branded Site

1. CO-BRANDED SITE

1.1. Unless otherwise mutually agreed, the look, feel, and co-branding elements of the Co-branded Site shall be consistent with Attachment A1 attached hereto and incorporated herein by reference.

1.2. The Co-branded Site shall be hosted by NetFlix[*].

1.3. Domain to be www.netflix.com/bestbuy, www.netflix.com/samgoody, www.netflix.com/mediaplay, www.netflix.com/oncue, www.netflix.com/suncoast, as applicable.

1.4. The Co-branded Site shall have Buy Buttons to the same extent and under the same terms as those for the NetFlix Site.

1.5. The Co-branded Site shall have no [*].

1.6. The parties agree to cooperate to launch the Co-branded Site in a phased approach as described in Section 5.1.1.

1.7. Upon Best Buy's request, NetFlix agrees to [*]in good faith the [*]for providing Best Buy with its own [*]to be [*]by[*].

2. [*]

2.1. NetFlix shall maintain [*]and [*]and maintain [*]on such[*]. NetFlix' [*]and[*], equipment, software, and telecommunications connections shall enable NetFlix to provide the Co-branded Site on and from such [*]within [*]hours of any[*].

3. [*]

3.1. NetFlix shall operate and maintain the Co-branded Site in good working order with access [*]to qualified [*]of [*]and persons specifically designated[*].

3.2. NetFlix shall undertake and perform all [*]to ensure [*]of all [*]Subscriber Information [*]on the Co-branded Site or its host servers, including, without limitation:[*].

4. [*]

4.1. All web pages within the Co-branded Site shall be [*]:

4.1.1. The Co-branded site may [*]that use [*]which may continue [*].

4.1.2. The Co-branded site may [*]for users with [*]which may be designed[*]appropriate to a [*]as long as such [*]use of the Co-branded Site, or [*]

5. [*]

5.1. Subscribers will be subject to [*]posted on [*].

5.2. A link to each of the [*]shall be clearly and conspicuously posted on every web page within the Co-branded Site where [*]is collected or requested.

6. TERMS AND CONDITIONS

6.1. The terms and conditions governing Subscriber and user access and use of the Co-branded Site and [*] shall be mutually agreed upon by the parties.

7. [*]

7.1. In the event the Co-branded Site [*]that [*]user and/or Subscriber [*] the Co-branded Site, [*] for the Co-branded Site shall [*]users and Subscribers of [*]and [*].

8. CO-BRANDED SITE [*]

8.1. NetFlix' [*]shall be such that the Co-branded Site is [*]at least[*].

9. TECHNOLOGICAL [*]

9.1. NetFlix shall automatically incorporate technological [*]made to the NetFlix Site into the Co-branded Site within a [*]day period.

10. CO-BRANDED SITE [*]

10.1. Subtract [*]from [*]

10.2. Divide the result of Section 10.1 by [*]

10.3. The result of Section 10.2 must be [*]to[*].

EXHIBIT B

1.1. [*]

EXHIBIT C

Best Buy's Promotional Obligations

1. The parties acknowledge that this Exhibit C may be amended from time to time upon mutual agreement of the parties in order to adapt to the marketplace and the success of certain marketing efforts or promotions.

2. Pursuant to the promotion calendar attached hereto and incorporated herein by reference as Attachment C1, Best Buy shall:

2.1. Promote the Co-branded Site in the[*]. Actual placement of any such advertising is in Best Buy's [*]discretion, provided that Best Buy shall use [*]to reach a total of [*]during the Term.

2.2. Send [*]marketing materials promoting the Co-branded Site via [*].

2.3. [*]or arrange for its designated agents to [*], the [*]to the [*] of all [*]that are shipped from [*]to the[*].

2.4. [*]via promotion of the Co-branded Site on [*]in Best Buy brick and mortar retail stores.

2.5. [*]via promotion of the Co-branded Site on all in-store [*]in Best Buy brick and mortar retail stores.

2.6. [*]via promotion of the Co-branded Site on [*]of Best Buy brick and mortar retail stores.

2.7. [*]the Co-branded Site on the [*]of the www.bestbuy.com homepage. Actual placement [*] shall be in Best Buy's[*], provided that Best Buy shall use its [*]to achieve[*].

2.8. [*]the Co-branded Site on the [*]web pages of the Best Buy Site. Actual placement [*] shall be in Best Buy's[*], provided that Best Buy shall use [*]to achieve[*].

2.9. [*] the Co-branded Site on [*]of the Best Buy Site. Actual placement [*] shall be in Best Buy's[*], provided that Best Buy shall use its [*]to achieve[*].

2.10. [*] the Co-branded Site on Best Buy's[*]. Actual placement [*] shall be in Best Buy's[*], provided that Best Buy shall use its [*]to achieve[*].

3. Best Buy shall use its [*]to place a co-branded insert promoting the Co-branded Site inside the [*]of titles with total sales of at least [*]at Best Buy over the [*]of this Agreement.

3.1. In the event that logistical issues surrounding this marketing element prevent Best Buy from fulfilling this obligation, NetFlix understands and acknowledges that Best Buy will [*]to perform this marketing effort.

3.2. NetFlix also understands and acknowledges that certain Best Buy [*]participate in this marketing effort.

3.3. Best Buy shall use its [*]to place [*] promoting the Co-branded Site on the[*].

EXHIBIT D

1.1. [*]

ATTACHMENT A1

CO-BRANDING EXAMPLES, [*]

ATTACHMENT C1

PROMOTION CALENDAR

[*]

Exhibit 99.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Reed Hastings, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Netflix, Inc. on Form 10-Q for the quarterly period ended June 30, 2002 fully complies with the requirements of Section 13 (a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report fairly presents in all material respects the financial condition and results of operations of Netflix, Inc.

By:	/s/ Reed Hastings
Name:	Reed Hastings
Title:	Chief Executive Officer

I, Barry McCarthy, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Netflix, Inc. on Form 10-Q for the quarterly period ended June 30, 2002 fully complies with the requirements of Section 13 (a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report fairly presents in all material respects the financial condition and results of operations of Netflix, Inc.

By:	/s/ Barry McCarthy
Name:	Barry McCarthy
Title:	Chief Financial Officer