NETFLIX INC
Form 10-Q
November 02, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from_____ to_____

Commission File Number: 000-49802

Netflix, Inc.

(Exact name of Registrant as specified in its charter)

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

100 Winchester Circle, Los Gatos, California 95032

(Address and zip code of principal executive offices)

(408) 540-3700

(Registrant s telephone number, including area code)

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

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

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

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

As of October 31, 2007, there were 65,776,952 shares of the registrant s common stock, par value $0.001, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. **Condensed Consolidated Financial Statements**

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Netflix, Inc.

Condensed Consolidated Statements of Operations

(unaudited)

(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
Revenues	$ 255,950	$ 293,972	$ 719,427	$ 902,985
Cost of revenues:				
Subscription	135,210	163,707	390,035	495,734
Fulfillment expenses*	23,583	30,746	67,602	90,384
Total cost of revenues	158,793	194,453	457,637	586,118
Gross profit	97,157	99,519	261,790	316,867
Operating expenses:				
Technology and development *	11,929	18,216	35,178	52,838
Marketing *	59,367	49,166	159,366	166,559
General and administrative *	9,948	12,895	25,013	38,930
Gain on disposal of DVDs	(1,142)	(2,310)	(3,493)	(5,500)
Gain on legal settlement				(7,000)
Total operating expenses	80,102	77,967	216,064	245,827
Operating income	17,055	21,552	45,726	71,040
Other income:				
Interest and other income	4,687	5,089	10,840	15,411
Income before income taxes	21,742	26,641	56,566	86,451
Income taxes	8,961	10,909	22,344	35,275
Net income	$ 12,781	$ 15,732	$ 34,222	$ 51,176
Net income per share:				
Basic	$ 0.19	$ 0.24	$ 0.56	$ 0.76
Diluted	$ 0.18	$ 0.23	$ 0.50	$ 0.74
Weighted average common shares outstanding:				
Basic	68,081	66,469	60,606	67,723
Diluted	70,345	68,090	68,626	69,560
*** Stock-based compensation included in expense line items:**				
Fulfillment expenses	$ 213	$ 99	$ 696	$ 327
Technology and development	884	1,002	2,716	2,590
Marketing	540	547	1,623	1,599
General and administrative	1,532	1,465	4,531	4,218

See accompanying notes to condensed consolidated financial statements.

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Netflix, Inc.

Condensed Consolidated Balance Sheets

(unaudited)

(in thousands, except share and par value data)

	As of	
	December 31, 2006	September 30, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 400,430	$ 179,804
Short-term investments		206,377
Prepaid expenses	4,742	6,078
Prepaid revenue sharing expenses	9,456	7,553
Deferred tax assets	3,155	2,809
Other current assets	10,635	15,697
Total current assets	428,418	418,318
Content library, net	104,908	114,254
Property and equipment, net	55,503	71,616
Deferred tax assets	15,600	16,512
Other assets	4,350	3,497
Total assets	$ 608,779	$ 624,197
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 93,864	$ 89,494
Accrued expenses	29,905	42,017
Deferred revenue	69,678	56,321
Total current liabilities	193,447	187,832
Deferred rent	1,121	1,927
Total liabilities	194,568	189,759
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.001 par value; 160,000,000 shares authorized at December 31, 2006 and September 30, 2007; 68,612,463 and 65,667,491 issued and outstanding at December 31, 2006 and September 30, 2007, respectively	69	66
Additional paid-in capital	454,731	423,048
Accumulated other comprehensive income		737
Retained earnings (accumulated deficit)	(40,589)	10,587
Total stockholders equity	414,211	434,438
Total liabilities and stockholders equity	$ 608,779	$ 624,197

See accompanying notes to condensed consolidated financial statements.

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Netflix, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
Cash flows from operating activities:				
Net income	$ 12,781	$ 15,732	$ 34,222	$ 51,176
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation of property and equipment	4,066	5,752	11,529	15,479
Amortization of content library	36,253	48,237	95,444	148,664
Amortization of intangible assets	25	25	48	74
Amortization of discounts and premiums on investments		23		(48)
Stock-based compensation expense	3,169	3,113	9,566	8,734
Excess tax benefits from stock-based compensation	(3,923)	(5,170)	(7,565)	(21,264)
Loss (gain) on disposal of property and equipment		128	(23)	128
Gain on sale of short-term investments		(170)		(364)
Gain on disposal of DVDs	(2,241)	(3,937)	(6,319)	(11,731)
Deferred taxes	4,126	(300)	13,499	(1,060)
Changes in operating assets and liabilities:				
Prepaid expenses and other current assets	(143)	111	(3,930)	(4,495)
Accounts payable	(2,624)	6,048	30	(387)
Accrued expenses	9,049	11,433	12,641	33,376
Deferred revenue	846	(4,201)	1,342	(13,357)
Deferred rent	78	741	267	806
Net cash provided by operating activities	61,462	77,565	160,751	205,731
Cash flows from investing activities:				
Purchases of short-term investments		(51,972)		(370,112)
Proceeds from sale of short-term investments		41,264		165,379
Purchases of property and equipment	(5,231)	(7,412)	(15,809)	(34,393)
Acquisition of intangible asset			(585)	
Acquisitions of content library	(37,255)	(39,452)	(113,239)	(165,346)
Proceeds from sale of DVDs	3,675	4,760	8,909	17,756
Proceeds from disposal of property and equipment			23	
Other assets	(311)	615	(528)	779
Net cash used in investing activities	(39,122)	(52,197)	(121,229)	(385,937)
Cash flows from financing activities:				
Proceeds from issuance of common stock	776	417	109,398	3,864
Excess tax benefits from stock-based compensation	3,923	5,170	7,565	21,264
Repurchases of common stock		(35,333)		(65,548)
Net cash (used in) provided by financing activities	4,699	(29,746)	116,963	(40,420)
Net increase (decrease) in cash and cash equivalents	27,039	(4,378)	156,485	(220,626)

Cash and cash equivalents, beginning of period	341,702	184,182	212,256	400,430
Cash and cash equivalents, end of period	$ 368,741	$ 179,804	$ 368,741	$ 179,804

See accompanying notes to condensed consolidated financial statements.

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Netflix, Inc.

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed consolidated interim financial statements of Netflix, Inc. and its wholly owned subsidiary (the Company) have been prepared in conformity with accounting principles generally accepted in the United States and are consistent in all material respects with those applied in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Examples include the estimate of useful lives and residual value of its content library; the valuation of stock-based compensation; and the recognition and measurement of income tax assets and liabilities. The actual results experienced by the Company may differ from management s estimates.

The interim financial information is unaudited, but reflects all normal recurring adjustments that are, in the opinion of management, necessary to fairly present the information set forth herein. The interim financial statements should be read in conjunction with the audited financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (the SEC) on February 28, 2007. Interim results are not necessarily indicative of the results for a full year.

Reclassifications

Certain amounts in the Company s condensed consolidated statements of cash flows for the nine months ended September 30, 2007 were reclassified to conform to the current period presentation. For the six months ended June 30, 2007, the change in accounts payable within cash provided by operating activities included amounts payable for acquisition of content of $7.0 million. This amount should have been reflected as a reduction to acquisition of content within net cash used in investing activities. As this amount was considered immaterial, we have reclassified $7.0 million from accounts payable within net cash provided by operating activities to acquisition of content library within net cash used in investing activities for the nine months ended September 30, 2007, and will reclassify for the three and six months ended June 30, 2007 in future filings. This reclassification does not have an impact on revenues, net income or net income per share for the impacted periods. The following table reflects the impact of the reclassification:

	Three Months Ended June 30,	Six Months Ended June 30,
	2007	2007
Changes in accounts payable:		
As previously reported	$ (10,850)	$ 549
Reclassifications	(6,984)	(6,984)
As Reclassified	$ (17,834)	$ (6,435)
Cash flows from operating activities:		
As previously reported	$ 72,121	$ 135,150
Reclassifications	(6,984)	(6,984)
As Reclassified	$ 65,137	$ 128,166
Acquisitions of content library:		
As previously reported	$ (64,337)	$ (132,878)
Reclassifications	6,984	6,984
As Reclassified	$ (57,353)	$ (125,894)
Net cash used in investing activities:		

As previously reported	$	(90,881)	$	(340,724)
Reclassifications		6,984		6,984
As Reclassified	$	(83,897)	$	(333,740)

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Fair Value of Financial Instruments

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

Cash Equivalents and Short-term Investments

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

Restricted Cash

As of September 30, 2006 and 2007, other assets included restricted cash of $0.8 million and $1.5 million, respectively, related to workers compensation insurance deposits. In addition, as of September 30, 2006 and 2007, other current assets included $2.2 million and $2.3 million, respectively, set aside for plaintiffs attorneys fees and expenses in the *Chavez vs. Netflix, Inc.* lawsuit.

Content Library

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

The Company amortizes its DVDs, less estimated salvage value, on a sum-of-the-months accelerated basis over their estimated useful lives. The useful life of the new-release DVDs and back-catalog DVDs is estimated to be 1 year and 3 years, respectively. In estimating the useful life of its DVDs, the Company takes into account library utilization as well as an estimate for lost or damaged DVDs. Volume purchase discounts received from studios on the purchase of titles are recorded as a reduction of DVD inventory when earned.

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

The Company amortizes license fees on Internet-based content on a straight-line basis over the term of the license agreement.

Amortization of Intangible Assets

Intangible assets are carried at cost less accumulated amortization. The Company amortizes the intangible assets with finite lives using the straight-line method over the estimated economic lives of the assets, ranging from approximately 10 years to 14 years. Intangible assets are included as part of other assets in the condensed consolidated balance sheets. In the first quarter of 2007, the Company wrote off fully amortized intangible assets of $11.9 million.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the shorter of the estimated useful lives of the respective assets, generally up to 5 years, or the lease term for leasehold improvements, if applicable.

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Impairment of Long-Lived Assets

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

Capitalized Software Costs

The Company accounts for software development costs, including costs to develop software products or the software component of products to be marketed to external users, as well as software programs to be used solely to meet the Company s internal needs in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed,* and Statement of Position (SOP) No. 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*. Costs related to products to be marketed to external users are capitalized once technological feasibility has been reached. Costs incurred during the application development stage for software programs to be used solely to meet our internal needs are capitalized. Capitalized software costs are included in property and equipment, net and are amortized over the estimated useful life of the software, which is generally up to three years.

Revenue Recognition

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

Cost of Revenues

Subscription. Cost of subscription consists of postage and packaging expenses, amortization of the content library and revenue sharing expenses related to shipping titles and the delivery of Internet-based content to paying subscribers. Revenue sharing expenses are recorded when either a) DVDs are shipped to subscribers or b) Internet-based content is viewed by subscribers.

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

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

Technology and Development

Technology and development expenses consist of payroll and related expenses incurred in testing, maintaining and modifying the Company s Web Site, its recommendation service, developing solutions for the Internet-based delivery of content to subscribers, telecommunications systems and infrastructure and other internal-use software systems. Technology and development expenses also include depreciation on computer hardware and capitalized software included in research and development activities.

Marketing

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

the advertising is run.

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

Income Taxes

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

Comprehensive Income

The Company reports comprehensive income or loss in accordance with the provisions of SFAS No. 130, *Reporting Comprehensive Income*, which establishes standards for reporting comprehensive income and its components in the financial statements. Other comprehensive income consists of unrealized gains and losses on available-for-sale securities, net of tax. See Note 4 to the condensed consolidated financial statements for further discussion.

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Net Income Per Share

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

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
	(in thousands, except per share data)			
Basic earnings per share:				
Net income	$ 12,781	$ 15,732	$ 34,222	$ 51,176
Shares used in computation:				
Weighted-average common shares outstanding	68,081	66,469	60,606	67,723
Basic earnings per share	$ 0.19	$ 0.24	$ 0.56	$ 0.76
Diluted earnings per share:				
Net income	$ 12,781	$ 15,732	$ 34,222	$ 51,176
Shares used in computation:				
Weighted-average common shares outstanding	68,081	66,469	60,606	67,723
Warrants	6		5,472	
Employee stock options and employee stock purchase plan shares	2,258	1,621	2,548	1,837
Weighted-average number of shares	70,345	68,090	68,626	69,560
Diluted earnings per share	$ 0.18	$ 0.23	$ 0.50	$ 0.74

For the three and nine months ended September 30, 2006 and 2007, employee stock options with exercise prices greater than the average market price of the common stock were excluded from the diluted calculation as their inclusion would have been anti-dilutive. For the three and nine months ended September 30, 2006, no outstanding warrants were excluded from the diluted calculation as their exercise prices were lower than the average market price of the common stock. There were no outstanding warrants during the three and nine months ended September 30, 2007.

The following table summarizes the outstanding potential common shares excluded from the diluted calculation:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
	(in thousands)		(in thousands)	
Employee stock options	1,452	2,660	1,223	2,071

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123 (revised 2004), *Share-Based Payment,* using the modified prospective method. The Company had previously adopted the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment of FASB Statement No. 123* in 2003, and restated prior periods at that time. Because the fair value recognition provisions of SFAS No. 123 and SFAS No. 123(R) were generally consistent, the adoption of SFAS No. 123(R) did not have a significant impact on the Company s financial position or results of operations. Upon the adoption of SFAS No. 123(R), the Company classified tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options as financing cash flows.

In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 regarding the SEC s interpretation of SFAS No. 123(R) and the valuation of share-based payments for public companies. The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R). See Note 6 to the condensed consolidated financial statements for a further discussion on stock-based compensation.

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Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 allows companies to choose to measure many financial instruments and certain other items at fair value. The statement requires that unrealized gains and losses on items for which the fair value option has been elected to be reported in earnings. SFAS No. 159 also amends certain provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. The Company does not expect the adoption of this standard to have a material effect on its financial position or results of operations.

2. Short-term Investments

As of September 30, 2007, short-term investments were classified as available-for-sale securities and are reported at fair value as follows:

	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Corporate debt securities	$ 34,445	$ 103	$ (79)	$ 34,469
Government and agency securities	131,161	1,177		132,338
Asset and mortgage backed securities	39,540	99	(69)	39,570
	$ 205,146	$ 1,379	$ (148)	$ 206,377

3. Content Library

Content library and accumulated amortization are as follows:

	As of	
	December 31, 2006	September 30, 2007
	(in thousands)	
Content library, gross	$ 484,034	$ 627,950
Less accumulated amortization	(379,126)	(513,696)
Content library, net	$ 104,908	$ 114,254

4. Other Comprehensive Income

The components of comprehensive income are as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
	(in thousands)			
Net income	$ 12,781	$ 15,732	$ 34,222	$ 51,176
Other comprehensive income:				
Change in unrealized gain on available-for-sale securities, net of tax		1,258		737

Comprehensive income	$ 12,781	$ 16,990	$ 34,222	$ 51,913

5. Stock Repurchases

On April 18, 2007, the Company announced a stock repurchase program allowing the Company to repurchase up to $100.0 million of its common stock through the end of 2007. During the three months ended September 30, 2007, the Company repurchased 2,061,687 shares of common stock at an average price of $17.14 per share for an aggregate amount of $35.3 million. During the nine months ended September 30, 2007, the Company repurchased 3,444,149 shares of common stock at an average price of $19.03 per share for an aggregate amount of $65.5 million. Stock repurchases are accounted for under the retirement method as all shares repurchased have been retired. There were no unsettled share repurchases as of September 30, 2007.

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6. Employee Stock Benefit Plans

Employee Stock Purchase Plan

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

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

666,666 shares; and

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

Under the Company s ESPP, employees may purchase common stock of the Company through accumulated payroll deductions. The purchase price of the common stock acquired by employees participating in the ESPP is 85% of the closing price on either the first day of the offering period or the last day of the purchase period, whichever is lower. Through May 1, 2006, offering periods were twenty-four months, and the purchase periods were six months. Therefore, each offering period included four six-month purchase periods, and the purchase price for each six-month period was determined by comparing the closing prices on the first day of the offering period and the last day of the applicable purchase period. In this manner, the look-back for determining the purchase price was up to twenty-four months. However, effective May 1, 2006, the ESPP was amended so that the offering and purchase periods take place concurrently in consecutive six month increments. Under the amended ESPP, therefore, the look-back for determining the purchase price is six months. Employees may invest up to 15% of their gross compensation through payroll deductions. In no event shall an employee be permitted to purchase more than 8,334 shares of common stock during any six-month purchase period. As of September 30, 2007, 2,724,892 shares were available for future issuance under the 2002 Employee Stock Purchase Plan.

Stock Option Plans

In December 1997, the Company adopted the 1997 Stock Plan, which was amended and restated in October 2001. The 1997 Stock Plan provides for the issuance of stock purchase rights, incentive stock options or non-statutory stock options. As of September 30, 2007, 615,024 shares were reserved for future issuance upon the exercise of outstanding options under the 1997 Stock Plan.

In February 2002, the Company adopted the 2002 Stock Plan, which was amended and restated in May 2006. The 2002 Stock Plan provides for the grant of incentive stock options to employees and for the grant of non-statutory stock options and stock purchase rights to employees, directors and consultants. As of September 30, 2007, 4,241,323 shares were reserved for future issuance upon the exercise of outstanding options under the 2002 Stock Plan.

Vested stock options granted before June 30, 2004 can be exercised up to three months following termination of employment. Vested stock options granted after June 30, 2004 and before January 1, 2007 can be exercised up to one year following termination of employment. Vested stock options granted on or after January 1, 2007 can be exercised up to ten years following grant regardless of employment status.

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A summary of option activity during the nine months ended September 30, 2007 is as follows:

		Options Outstanding		Weighted-Average	
	Shares Available For Grant	Number of Shares	Weighted-Average Exercise Price	Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balances as of December 31, 2006	5,605,184	5,453,453	$ 14.23		
Granted	(230,445)	230,445	23.92		
Exercised		(149,480)	5.13		
Canceled	35,366	(35,366)	30.60		
Balances as of March 31, 2007	5,410,105	5,499,052	14.78	6.94	$ 55,623
Granted	(259,247)	259,247	22.35		
Exercised		(147,246)	4.51		
Canceled	24,231	(24,231)	29.42		
Balances as of June 30, 2007	5,175,089	5,586,822	15.34	6.87	$ 39,985
Granted	(339,202)	339,202	18.20		
Exercised		(90,996)	4.58		
Canceled	20,460	(20,460)	28.97		
Balances as of September 30, 2007	4,856,347	5,814,568	15.63	6.83	$ 43,750
Vested and exercisable as of September 30, 2007		5,814,568	15.63	6.83	43,750

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company s closing stock price on the last trading day of the third quarter of 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2007. This amount changes based on the fair market value of the Company s common stock. Total intrinsic value of options exercised during the three and nine months ended September 30, 2006 was $2.6 million and $23.1 million, respectively. Total intrinsic value of options exercised during the three and nine months ended September 30, 2007 was $1.3 million and $6.6 million, respectively.

Cash received from option exercises and purchases under the ESPP for the three and nine months ended September 30, 2006 was $0.8 million and $8.5 million, respectively, and $0.4 million and $3.8 million for the three and nine months ended September 30, 2007.

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Stock-Based Compensation

For newly granted options, beginning in January 2007, employee stock options will remain exercisable for the full ten year contractual term regardless of employment status. In conjunction with this change, the Company changed its method of calculating the fair value of new stock-based compensation awards granted under its stock option plans from a Black-Scholes model to a lattice-binomial model. The Company believes that the lattice-binomial model is more capable of incorporating the features of the Company s employee stock options than closed-form models such as the Black-Scholes model. The lattice-binomial model has been applied prospectively to options granted in 2007. The following table summarizes the assumptions used to value option grants using the Black-Scholes model in 2006 and a lattice-binomial model in 2007:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
Dividend yield	0%	0%	0%	0%
Expected volatility	46% -48%	48%	44% -53%	43% -48%
Risk-free interest rate	5.00%	4.92%	4.45% -5.00%	4.65% -4.92%
Expected life (in years)	3 -5		3 -5	
Suboptimal exercise factor		1.77 -2.06		1.77 -2.09
Post-vesting termination rate				

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

	Nine Months Ended	
	September 30, 2006	September 30, 2007
Dividend yield	0%	0%
Expected volatility	39%	41%
Risk-free interest rate	5.01%	5.07%
Expected life (in years)	0.5	0.5

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

The Company bifurcates its option grants into two employee groupings (executive and non-executive) based on exercise behavior and considers several factors in determining the estimate of expected life for each group, including the historical option exercise behavior, the terms and vesting periods of the options granted. In the three and nine months ended September 30, 2007, under the lattice-binomial model, the Company used a suboptimal exercise factor ranging from 2.06 to 2.09 for executives and 1.77 for non-executives, which resulted in a calculated expected life of the option grants of 5 years for executives and 4 years for non-executives. In the three and nine months ended September 30, 2006, under the Black-Scholes model, the Company used an estimated expected life of 5 years for executives and 3 years for non-executives, respectively.

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

The weighted-average fair value of employee stock options granted during the three and nine months ended September 30, 2006 was $9.43 and $10.82 per share, respectively. The weighted-average fair value of employee stock options granted during the three and nine months ended September 30, 2007 was $8.15 and $9.34 per share, respectively.

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The following table summarizes stock-based compensation expense, net of tax, related to stock option plans and employee stock purchases under SFAS No. 123(R) for the three and nine months ended September 30, 2006 and 2007 which was allocated as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
	(in thousands)			
Fulfillment expenses	$ 213	$ 99	$ 696	$ 327
Technology and development	884	1,002	2,716	2,590
Marketing	540	547	1,623	1,599
General and administrative	1,532	1,465	4,531	4,218
Stock-based compensation expense before income taxes	3,169	3,113	9,566	8,734
Income tax effect	(1,306)	(1,273)	(3,779)	(3,557)
Total stock-based compensation after income taxes	$ 1,863	$ 1,840	$ 5,787	$ 5,177

7. Income Taxes

On January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. The adoption of FIN No. 48 did not have a material effect on our financial position or results of operations. In addition, there are no uncertain tax positions whose resolution in the next 12 months is expected to materially affect operating results. The Company accounts for income taxes using the asset and liability method. Deferred income taxes are recognized by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for any tax benefits for which future realization is uncertain. The Company recognizes interest and/or penalties related to uncertain tax positions in income tax expense.

The Company files income tax returns in the U.S. federal jurisdiction and various states. The Company is subject to U.S. federal or state income tax examinations by tax authorities for years after 1997.

8. Legal Proceedings

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

On September 23, 2004, Frank Chavez, individually and on behalf of others similarly situated, filed a class action lawsuit against the Company in California Superior Court, City and County of San Francisco. The complaint asserts claims of, among other things, false advertising, unfair and deceptive trade practices, breach of contract as well as claims relating to the Company s statements regarding DVD delivery times. The Company entered into an amended settlement under which Netflix subscribers who were enrolled in a paid membership before January 15, 2005 and were a member on October 19, 2005 are eligible to receive a free one-month upgrade in service level and Netflix subscribers who were enrolled in a paid membership before January 15, 2005 and were not a member on October 19, 2005 are eligible to receive a free one-month Netflix membership of either the 1, 2 or 3 DVDs at-a-time unlimited program. The Court issued final judgment on the settlement on July 28, 2006, awarding plaintiffs attorneys fees and expenses of $2.1 million. The final judgment has been appealed to the California Court of Appeals, First Appellate District. The Appellate Court has not set a hearing date. In accordance with SFAS No. 5, *Accounting for Contingencies*, the Company estimated and recorded a charge against earnings in general and administrative expenses associated with the legal fees and the incremental expected costs for the free one month membership to former subscribers, of which $6.7 million is included in accrued expenses as of September 30, 2007. The charge for the free one month upgrade to the next level program for existing subscribers will be recorded when the subscribers utilize the upgrade. The actual cost of the settlement will be dependent upon many unknown factors such as the number of former

Netflix subscribers who will actually redeem the settlement benefit when it is made available following the appeal period. The Company denies any wrongdoing.

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

On January 31, 2007, Dennis Dilbeck filed a putative class action lawsuit against the Company in the United States District Court for the Northern District of California captioned *Dennis Dilbeck vs. Netflix, Inc.*, Civil Case No. C 07 00643 PVT. The complaint alleges that the Company violated antitrust and unfair competition laws in seeking to enforce two of its patents against Blockbuster, Inc. and other potential competitors, which patents were allegedly obtained by deceiving the U.S. Patent and Trademark Office. The complaint alleges that the Company s subscribers have paid artificially inflated subscription prices because potential competitors were allegedly deterred from entering the online DVD rental market by the Company s patents. The complaint purports to be on behalf of existing and past subscribers who allegedly would have paid lower subscription rates but for the alleged anticompetitive conduct. The complaint seeks injunctive relief, restitution and damages in an unspecified amount. Subsequently, two other consumer class actions were filed in the United States District Court for the Northern District of California *Melanie Polk-Stamps and Babacar Diene vs. Netflix, Inc.*, Civil Case C 07-01266 and S*teven Dassa v. Netflix, Inc.*, Civil Case C 07 1978 RS each of which alleged the same causes of actions and made the same request for damages as those set forth in the *Dilbeck* case. On March 17, 2007, the court entered an order consolidating all of the class actions. Netflix subsequently filed a motion to dismiss the consolidated case. On June 14, 2007, the court entered an order granting Netflix s motion to dismiss but allowing plaintiffs leave to file an amended complaint. After conducting some discovery, the plaintiffs did not amend their complaint and the parties requested that the case be dismissed. On October 22, 2007, the court granted the request that the case be dismissed.

On April 9, 2007, SBJ Holdings 1, LLC, filed a complaint for patent infringement against the Company in the United States District Court for the Eastern District of Texas, captioned *SBJ Holdings 1, LLC v. Netflix, Inc., Amazon.com, Inc. BarnesandNoble.com, LLC, and Borders Group, Inc*., Civil Action No. 2:07-cv-120-TJW. The complaint alleges that the Company infringed U.S. Patent No. 6,330,592 B1, entitled Method, Memory, Product, and Code for Displaying Pre-Customized Content Associated with Visitor Data , issued on December 11, 2001. The complaint seeks unspecified compensatory and enhanced damages, interest and fees, and seeks to permanently enjoin the defendants from infringing the patent in the future.

On August 23, 2007, Constellation IP, LLC, filed a complaint for patent infringement against the Company in the United States District Court for the Eastern District of Texas, captioned *Constellation IP, LLC v. The Allstate Corporation, et al.,* Civil Action No. 5:07-cv-00134. The complaint alleges that the Company infringed U.S. Patent No. 6,453,302 entitled Computer Generated Presentation System , issued on September 17, 2002. The complaint seeks unspecified compensatory and enhanced damages, interest and fees, and seeks to permanently enjoin the defendants from infringing the patent in the future.

On October 16, 2007, Refined Recommendation Corporation, filed a complaint for patent infringement against the Company in the United States District Court for the Eastern District of New Jersey, captioned *Refined Recommendation Corporation v. Netflix, Inc.,* Civil Action No. 2:07-cv-04981-DMC-MF. The complaint alleges that the Company infringed U.S. Patent No. 6,606,102 entitled Optimizing Interest Potential , issued on August 12, 2003. The complaint seeks unspecified compensatory and enhanced damages, interest and fees, and seeks to permanently enjoin the defendants from infringing the patent in the future.

9. Guarantees - Intellectual Property Indemnification Obligations

In the ordinary course of business, the Company has entered into contractual arrangements under which it has agreed to provide indemnification of varying scope and terms to business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company s breach of such agreements and out of intellectual property infringement claims made by third parties. In these circumstances, payment by the Company may be conditional on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party s claims. Further, the Company s obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by it under these agreements. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers that will require it, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. The terms of such obligations vary.

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

10. Related Party Transaction

In April 2007, the Company entered into a license agreement with a company in which an employee had a significant ownership interest. Under this agreement, the Company recorded a charge of $2.5 million in technology and development in the nine months ended September 30, 2007. Minimum additional payments of $0.5 million may be required if the Company meets certain milestones in the future.

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the federal securities laws. These forward-looking statements include, but are not limited to, statements regarding: average revenue per paying subscriber; revenue growth for the remainder of 2007; operating expenses; gross margin; liquidity; subscriber acquisition and retention; developments in our Internet-based delivery feature; and impacts relating to our pricing strategy. These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (SEC) on February 28, 2007 and in the Quarterly Reports on Form 10-Q filed with the SEC on May 7, 2007 and August 6, 2007.

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

Overview

Our Business

We are the largest online movie rental subscription service, providing more than 7.0 million subscribers access to approximately 90,000 DVD titles plus a growing library of more than 5,000 choices that can be watched instantly on their PCs. We offer nine subscription plans, starting at $4.99 a month. There are no due dates, no late fees and no shipping fees. Subscribers select titles at our Web Site aided by our proprietary recommendation service, receive them on DVD by U.S. mail and return them to us at their convenience using our prepaid mailers. After a DVD has been returned, we mail the next available DVD in a subscriber s queue. We also offer certain titles through our instant-viewing feature. The terms and conditions by which subscribers utilize our service and a more detailed description of how our service works can be found at *www.netflix.com/TermsOfUse*.

We generated revenue of $294.0 million and $903.0 million, respectively, during the three and nine months ended September 30, 2007 in comparison with revenue of $256.0 million and $719.4 million, respectively, during the three and nine months ended September 30, 2006. This growth is attributed to our expanding subscriber base, which grew from 5.7 million at September 30, 2006 to 7.0 million at September 30, 2007. Our net income was $15.7 million and $51.2 million, respectively, during the three and nine months ended September 30, 2007 in comparison with net income of $12.8 million and $34.2 million, respectively, during the three and nine months ended September 30, 2006. Diluted earnings per share was $0.23 and $0.74, respectively, for the three and nine months ended September 30, 2007 compared to $0.18 and $0.50, respectively, for the three and nine months ended September 30, 2006.

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We generated revenue of $294.0 million during the three months ended September 30, 2007 in comparison with revenue of $303.7 million during the three months ended June 30, 2007. During June and July of 2007, we lowered the prices of three of our most popular subscription plans, which resulted in a decline in revenues during the three months ended September 30, 2007. The decline in revenues was also attributed to the decline in average monthly revenue per paying subscriber resulting from the continued growth of our lower cost subscription plans. The decline in revenues was partially offset by growth in our subscriber base. Our net income was $15.7 million during the three months ended September 30, 2007 in comparison with net income of $25.6 million during the three months ended June 30, 2007. Diluted earnings per share was $0.23 for the three months ended September 30, 2007 compared to $0.37 for the three months ended June 30, 2007.

Key Business Metrics

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

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

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

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

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

Recent Developments and Initiatives

In late 2006, Blockbuster launched its integrated store-based and online program, Total Access, whereby Blockbuster online subscribers may return DVDs delivered to them from Blockbuster Online to Blockbuster stores in exchange for an in-store rental. During 2007, Blockbuster began aggressively promoting and pricing their Total Access program through in-store promotions and sign-ups as well as advertising on television and other mass-media channels. However, in the third quarter of 2007, Blockbuster modified their Total Access program and indicated their intent to decrease discretionary marketing spending. As a result, we expect to see renewed subscriber growth.

Our core strategy is to grow a large DVD subscription business and to expand into Internet-based delivery of content as that market develops. We believe that the DVD format, along with its successor formats of HD DVD and Blu-Ray, will continue to be the main vehicle for watching content in the home for the foreseeable future and that by growing a large DVD subscription business, we will be well positioned to transition our subscribers and our business to Internet-based delivery as it becomes a mainstream method for content distribution. To this end, we introduced a new feature in January 2007 that allows subscribers to instantly watch movies and television series on their personal computers. We will continue to improve its quality, content and functionality. We intend to broaden the distribution capability of this service to multiple platforms over time.

We expect revenue to increase slightly during the three months ended December 31, 2007 as compared to the three months ended September 30, 2007, due to growth in our subscriber base, partially offset by a decline in average monthly revenue per paying subscriber resulting from the continued growth of our lower cost subscription plans.

Critical Accounting Policies and Estimates

Other than the change in the method of calculating the fair value of new stock-based compensation awards, there have been no significant changes during the nine months ended September 30, 2007 to the items that we disclosed as our critical accounting policies and estimates in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended

December 31, 2006.

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Stock-Based Compensation

We adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R) on January 1, 2006. Under the fair value recognition provisions of this statement, stock-based compensation cost is estimated at the grant date based on the fair value of the awards expected to vest and is recognized as expense ratably over the requisite service period, which is the vesting period. We adopted the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment of FASB Statement No. 123,* in the second quarter of 2003 and restated prior periods at that time. Because the fair value recognition provisions of SFAS No. 123 and SFAS No. 123(R) were materially consistent under our equity plans, the adoption of SFAS No. 123(R) did not have a significant impact on our financial position or results of operations.

We changed our method of calculating the fair value of new stock-based compensation awards granted under our stock plans from a Black-Scholes model to a lattice-binomial model. We continue to use a Black-Scholes model to determine the fair value of employee stock purchase plan shares. The lattice-binomial model has been applied prospectively to options granted subsequent to January 1, 2007. The lattice-binomial model requires the input of highly subjective assumptions, including the option s price volatility of the underlying stock. Changes in the subjective input assumptions can materially affect the estimate of fair value of options granted and our results of operations could be materially impacted.

Expected Volatility: Our computation of expected volatility is based on a blend of historical volatility of our common stock and implied volatility of tradable forward call options to purchase shares of our common stock. Our decision to incorporate implied volatility was based on our assessment that implied volatility of publicly traded options in our common stock is more reflective of market conditions and, therefore, can reasonably be expected to be a better indicator of expected volatility than historical volatility of our common stock.

Suboptimal Exercise Factor: Our computation of the suboptimal exercise factor is based on historical option exercise behavior and the terms and vesting periods of the options granted, and is determined for both executives and non-executives.

We grant stock options to our employees on a monthly basis. We have elected to grant all options as non-qualified stock options which vest immediately. As a result of immediate vesting, stock-based compensation expense determined under SFAS No. 123(R) is fully recognized upon the stock option grants and no estimate is required for pre-vesting option forfeitures.

See Note 6 to the condensed consolidated financial statements for further information regarding the SFAS No. 123(R) disclosures.

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Results of Operations

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

	Three Months Ended			Nine Months Ended	
	September 30, 2006	June 30, 2007	September 30, 2007	September 30, 2006	September 30, 2007
Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues:					
Subscription	52.8%	54.9%	55.6%	54.2%	54.9%
Fulfillment expenses	9.2%	9.9%	10.5%	9.4%	10.0%
Total cost of revenues	62.0%	64.8%	66.1%	63.6%	64.9%
Gross profit	38.0%	35.2%	33.9%	36.4%	35.1%
Operating expenses:					
Technology and development	4.7%	6.2%	6.2%	4.9%	5.9%
Marketing	23.2%	14.9%	16.7%	22.2%	18.4%
General and administrative	3.9%	4.6%	4.4%	3.5%	4.3%
Gain on disposal of DVDs	(0.5%)	(0.8%)	(0.8%)	(0.6%)	(0.6%)
Gain on legal settlement		(2.3%)			(0.8%)
Total operating expenses	31.3%	22.6%	26.5%	30.0%	27.2%
Operating income	6.7%	12.6%	7.4%	6.4%	7.9%
Other income:					
Interest and other income	1.8%	1.6%	1.7%	1.5%	1.7%
Income before income taxes	8.5%	14.2%	9.1%	7.9%	9.6%
Income taxes	3.5%	5.8%	3.7%	3.1%	3.9%
Net income	5.0%	8.4%	5.4%	4.8%	5.7%

Revenues

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2006	June 30, 2007	September 30, 2007	Q3 07 vs. Q3 06	Q3 07 vs Q2 07	September 30, 2006	September 30, 2007	Q3 07 vs. Q3 06
	(in thousands except percentages and average monthly revenue per paying subscriber)							
Revenues	$ 255,950	$ 303,693	$ 293,972	14.9%	(3.2%)	$ 719,427	$ 902,985	25.5%
Average number of paying subscribers	5,253	6,643	6,727	28.1%	1.3%	4,836	6,595	36.4%
Average monthly revenue per paying subscriber	$ 16.24	$ 15.24	$ 14.57	(10.3%)	(4.4%)	$ 16.53	$ 15.21	(8.0%)

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

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

The increase in our revenues in the three and nine months ended September 30, 2007 as compared to the same prior-year periods was primarily a result of the substantial growth in the average number of paying subscribers, as summarized in the table above, arising from increased consumer awareness of the benefits of online DVD rentals. This increase was offset in part by a decline in average monthly revenue per paying subscriber resulting from the continued growth in our lower cost subscription plans.

Three months ended June 30, 2007 as compared to the three months ended September 30, 2007

The decrease in our revenues in the three months ended September 30, 2007 as compared to the three months ended June 30, 2007 was primarily attributable to the decline in average monthly revenue per paying subscriber arising from the lowered prices of three of our most popular subscription plans and the continued growth in our lower cost subscription plans. The decrease was partially offset by growth in our subscriber base.

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During June and July of 2007, we lowered the prices of three of our most popular subscription plans. As a result, we expect the growth in revenue to continue to slow during the remainder of 2007, as compared to 2006. However, we believe that revenue will increase slightly during the three months ended December 31, 2007 as compared to the three months ended September 30, 2007, due to growth in our subscriber base offset by the decline in average monthly revenue per paying subscriber resulting from the continued growth of our lower cost subscription plans.

Subscriber churn was 4.2% in the third quarter of 2007 and in the third quarter of 2006, as compared to 4.6% in the second quarter of 2007. We believe the decrease was primarily due to the reduced pricing of our three most popular plans and reduced competition. In addition, we continued improving the overall service quality and value to our subscribers. We believe these continuing improvements to our service increase subscriber satisfaction, which results in lower churn.

The following table presents our ending subscriber information:

	As of		
	September 30, 2006	June 30, 2007	September 30, 2007
	(in thousands, except percentages)		
Free subscribers	173	133	183
As a percentage of total subscribers	3.1%	2.0%	2.6%
Paid subscribers	5,489	6,609	6,845
As a percentage of total subscribers	96.9%	98.0%	97.4%
Total subscribers	5,662	6,742	7,028

Cost of Revenues

Subscription

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2006	June 30, 2007	September 30, 2007	Q3 07 vs. Q3 06	Q3 07 vs Q2 07	September 30, 2006	September 30, 2007	Q3 07 vs. Q3 06
	(in thousands, except percentages)							
Subscription	$ 135,210	$ 166,838	$ 163,707	21.1%	(1.9%)	$ 390,035	$ 495,734	27.1%
As a percentage of revenues	52.8%	54.9%	55.6%			54.2%	54.9%	

Cost of subscription revenues consists of postage and packaging expenses, amortization of our content library and revenue sharing expenses related to shipping titles and the Internet-based delivery of content to paying subscribers. Costs related to free-trial subscribers are allocated to marketing expenses.

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

The increase in cost of subscription revenues for the three months and nine months ended September 30, 2007 as compared to the same prior-year periods was primarily attributable to the following factors:

The number of DVDs mailed to paying subscribers increased 15% and 22% in the three and nine months ended September 30, 2007, respectively, which was driven by an increase of 28% and 36%, respectively, in the number of average paying subscribers. This increase was partially offset by a decline in monthly movie rentals per average paying subscriber attributed to the continued growth of our lower priced plans.

Postage and packaging expenses increased by 21% and 25% in the three and nine months ended September 30, 2007, respectively. This increase was primarily attributable to an increase in the average number of paying subscribers and the number of DVDs mailed to paying subscribers, as well as an increase in the rate of first class postage in the amount of $0.02 in May 2007. This increase was

offset by a decline in monthly movie rentals per average paying subscriber due to the continued growth of our lower priced subscription plans.

Content amortization increased by 27% and 51% in the three and nine months ended September 30, 2007, respectively. This increase was primarily attributable to increased acquisitions of our content library. In addition, costs related to our instant-viewing feature have been included in costs of subscriptions since its introduction in January 2007.

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Three months ended June 30, 2007 as compared to the three months ended September 30, 2007

Cost of subscription revenues for the three months ended September 30, 2007 decreased as compared to the three months ended June 30, 2007 due to a decrease in revenue sharing expenses and disc depreciation resulting from a decrease in content acquisitions during the third quarter of 2007, offset by an increase in postage and packaging expenses and an increase in content costs related to our instant-viewing feature. This decrease in content acquisitions was primarily attributable to the seasonal decline in studio output during the three months ended September 30, 2007.

Fulfillment expenses

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2006	June 30, 2007	September 30, 2007	Q3 07 vs. Q3 06	Q3 07 vs Q2 07	September 30, 2006	September 30, 2007	Q3 07 vs. Q3 06
	(in thousands, except percentages)							
Fulfillment expenses	$ 23,583	$ 29,855	$ 30,746	30.4%	3.0%	$ 67,602	$ 90,384	33.7%
As a percentage of revenues	9.2%	9.9%	10.5%			9.4%	10.0%	

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

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

The increase in fulfillment expenses for the three and nine months ended September 30, 2007 as compared to the same prior-year periods was primarily attributable to an increase in credit card fees as a result of the growth in subscriptions. In addition, increased headcount and the addition of new shipping centers resulted in higher personnel and facility related costs during the first nine months of 2007.

Three months ended June 30, 2007 as compared to the three months ended September 30, 2007

Fulfillment expenses for the three months ended September 30, 2007 slightly increased as compared to the three months ended June 30, 2007 primarily due to personnel-related costs.

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Gross Margin

	Three Months Ended			Nine Months Ended	
	September 30, 2006	June 30, 2007	September 30, 2007	September 30, 2006	September 30, 2007
	(in thousands, except percentages)				
Gross profit	$ 97,157	$ 107,000	$ 99,519	$ 261,790	$ 316,867
Gross margin	38.0%	35.2%	33.9%	36.4%	35.1%

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

The decrease in gross margin for the three and nine months ended September 30, 2007 as compared to the same prior-year periods was primarily due to the increase in the rate of first class postage in the amount of $0.02 in May 2007 and increases in content amortization associated with Internet-based delivery of content.

Three months ended June 30, 2007 as compared to the three months ended September 30, 2007

The decrease in gross margin for the three months ended September 30, 2007 as compared to the three months ended June 30, 2007 was primarily attributable to a decrease in revenues due to the lowered prices of three of our most popular subscription plans, as well as the increase in the rate of first class postage in May 2007.

We anticipate that gross margin will continue to decline as a result of our lower prices and our continued investment in content for Internet-based delivery.

Technology and Development

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2006	June 30, 2007	September 30, 2007	Q3 07 vs. Q3 06	Q3 07 vs Q2 07	September 30, 2006	September 30, 2007	Q3 07 vs. Q3 06
	(in thousands, except percentages)							
Technology and development	$ 11,929	$ 18,907	$ 18,216	52.7%	(3.7%)	$ 35,178	$ 52,838	50.2%
As a percentage of revenues	4.7%	6.2%	6.2%			4.9%	5.9%	

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

Technology and development expenses increased $6.3 million and $17.7 million, respectively, during the three and nine months ended September 30, 2007 as compared to the same prior-year periods. The increases were primarily the result of an increase in personnel-related costs due to an increase in headcount and increased expenses related to the development of solutions for the Internet-based delivery of content.

Three months ended June 30, 2007 as compared to the three months ended September 30, 2007

Technology and development expenses decreased $0.7 million during the three months ended September 30, 2007 as compared to the three months ended June 30, 2007 primarily due to a decrease in expenses related to the development of solutions for the Internet-based delivery of content offset by increased personnel-related costs due to an increase in headcount.

We continuously research and test a variety of potential improvements to our internal hardware and software systems in an effort to improve our productivity and enhance our subscribers experience. In addition, we continue to develop solutions for the Internet-based delivery of content to our subscribers. As such, we expect that our technology and development expenses will increase slightly for the remainder of 2007.

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Marketing

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2006	June 30, 2007	September 30, 2007	Q3 07 vs. Q3 06	Q3 07 vs Q2 07	September 30, 2006	September 30, 2007	Q3 07 vs. Q3 06
	(in thousands, except percentages and subscriber acquisition cost)							
Marketing	$ 59,367	$ 45,255	$ 49,166	(17.2%)	8.6%	$ 159,366	$ 166,559	4.5%
As a percentage of revenues	23.2%	14.9%	16.7%			22.2%	18.4%	
Other data:								
Gross subscriber additions	1,310	1,028	1,297	(1.0%)	26.2%	3,757	3,845	2.3%
Subscriber acquisition cost	$ 45.32	$ 44.02	$ 37.91	(16.4%)	(13.9%)	$ 42.42	$ 43.32	2.1%

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

Marketing expenses decreased $10.2 million during the three months ended September 30, 2007 as compared to the same prior-year period. The decrease was primarily attributable to a decrease in marketing program costs, principally in online advertising and package inserts. Subscriber acquisition cost decreased for the three months ended September 30, 2007 as compared to the same prior-year period primarily due to faster subscriber growth from free acquisition channels, such as word-of-mouth.

Marketing expenses increased $7.2 million during the nine months ended September 30, 2007 as compared to the same prior-year period. The increase was primarily attributable to an increase in marketing program costs during the first quarter of 2007, principally direct mail and online advertising, to attract new subscribers. Subscriber acquisition cost increased for the nine months ended September 30, 2007 as compared to the same prior-year period primarily due to slower subscriber growth from free acquisition channels, such as word-of-mouth, due to increased competition.

We expect that our marketing expenses will increase for the remainder of 2007.

Three months ended June 30, 2007 as compared to the three months ended September 30, 2007

Marketing expenses increased $3.9 million during the three months ended September 30, 2007 as compared to the three months ended June 30, 2007. The increase was attributable to an increase in marketing program spending, primarily in online advertising, during the third quarter of 2007.

Subscriber acquisition cost decreased for the three months ended September 30, 2007 as compared to the three months ended June 30, 2007 due to a mix of lower prices, more efficient spending and competitors lighter marketing.

General and Administrative

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2006	June 30, 2007	September 30, 2007	Q3 07 vs. Q3 06	Q3 07 vs Q2 07	September 30, 2006	September 30, 2007	Q3 07 vs. Q3 06
	(in thousands, except percentages)							
General and administrative	$ 9,948	$ 13,847	$ 12,895	29.6%	(6.9%)	$ 25,013	$ 38,930	55.6%
As a percentage of revenues	3.9%	4.6%	4.4%			3.5%	4.3%	

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

General and administrative expenses increased $2.9 million and $13.9 million, respectively, during the three and nine months ended September 30, 2007 as compared to the same prior-year periods. The increase was primarily attributable to an increase in personnel-related costs due to an increase in headcount. The increase was also attributable to higher costs related to legal proceedings.

We expect that our general and administrative expenses will increase for the remainder of 2007.

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Three months ended September 30, 2007 as compared to the three months ended June 30, 2007

General and administrative expenses decreased $1.0 million during the three months ended September 30, 2007 as compared to the three months ended June 30, 2007, primarily due to lower costs related to legal proceedings.

Gain on Legal Settlement

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

Interest and Other Income

	Three Months Ended			Change		Nine Months Ended		Change
	September 30, 2006	June 30, 2007	September 30, 2007	Q3 07 vs. Q3 06	Q3 07 vs Q2 07	September 30, 2006	September 30, 2007	Q3 07 vs. Q3 06
	(in thousands, except percentages)							
Interest and other income	$ 4,687	$ 4,972	$ 5,089	8.6%	2.4%	$ 10,840	$ 15,411	42.2%
As a percentage of revenues	1.8%	1.6%	1.7%			1.5%	1.7%	

Three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2007

The increase in interest and other income for the three and nine months ended September 30, 2007 as compared with the same prior-year periods was primarily due to a higher short-term investments balance which resulted in increased interest income.

Three months ended September 30, 2007 as compared to the three months ended June 30, 2007

The increase in interest and other income for the three months ended September 30, 2007 as compared to the three months ended June 30, 2007 was primarily attributable to a higher short-term investments balance during the quarter which resulted in increased interest income.

Income Taxes

	Three Months Ended			Nine Months Ended	
	September 30, 2006	June 30, 2007	September 30, 2007	September 30, 2006	September 30, 2007
	(in thousands, except percentages)				
Income taxes	$ 8,961	$ 17,665	$ 10,909	$ 22,344	$ 35,275
Effective tax rate	41.2%	40.8%	40.9%	39.5%	40.8%

On January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. The adoption of FIN No. 48 did not have a material effect on our financial position or results of operations. In addition, there are no uncertain tax positions whose resolution in the next 12 months is expected to materially affect operating results. Our effective tax rate for the third quarter of 2007 differed from the federal statutory rate due primarily to state taxes. The decrease in our effective tax rate for the three months ended September 30, 2007 as compared to the same prior-year period was primarily attributable to state tax adjustments that were recorded in the third quarter of 2006. The increase in our effective tax rate for the nine months ended September 30, 2007 as compared to the same prior-year period was primarily attributable to a reduction in disqualifying dispositions.

The Company files income tax returns in the U.S. federal jurisdiction and various states. The Company is subject to U.S. federal or state income tax examinations by tax authorities for years after 1997.

Liquidity and Capital Resources

As of September 30, 2007, we had cash and cash equivalents of $179.8 million and short-term investments of $206.4 million, for a combined total of $386.2 million. We started an investment portfolio during the first quarter of 2007 in an attempt to earn a better return on our cash

balance. Short-term investments are comprised of corporate debt securities, government and agency securities and asset and mortgage-backed securities. The portfolio is invested in AAA rated residential and commercial mortgage-backed securities. The mortgage bonds owned represent the senior tranches of the capital structure and provide credit enhancement through over-collateralization and their subordinated characteristics.

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On April 18, 2007, the Company announced a stock repurchase program allowing the Company to repurchase up to $100.0 million of its common stock through the end of 2007.

We have generated net cash from operations during each quarter since the second quarter of 2001. Many factors will impact our ability to continue to generate and grow cash from our operations including, but not limited to, the number of subscribers who sign up for our service, the growth or reduction in our subscriber base, and our ability to develop new revenue sources. In addition, we may have to or otherwise choose to further lower our prices and increase our marketing expenses in order to grow faster or respond to competition. Although we currently anticipate that cash flows from operations, together with our available funds, will be sufficient to meet our cash needs for the foreseeable future, we may require or choose to obtain additional financing. Our ability to obtain financing will depend on, among other things, our development efforts, business plans, operating performance and the condition of the capital markets at the time we seek financing.

The following table summarizes our cash flow activities:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
	(in thousands)			
Net cash provided by operating activities	$ 61,462	$ 77,565	$ 160,751	$ 205,731
Net cash used in investing activities	(39,122)	(52,197)	(121,229)	(385,937)
Net cash (used in) provided by financing activities	4,699	(29,746)	116,963	(40,420)

Operating activities

Cash provided by operating activities during the three months ended September 30, 2007 consisted primarily of net income of $15.7 million increased by non-cash amortization of content library of $48.2 million, depreciation of property and equipment of $5.8 million and an increase in accounts payable and accrued expenses of $6.0 million and $11.4 million, respectively. These increases were partially offset by the excess tax benefits from stock-based compensation of $5.2 million and a decrease in deferred revenue of $4.2 million.

Cash provided by operating activities during the nine months ended September 30, 2007 consisted primarily of net income of $51.2 million increased by non-cash amortization of content library of $148.7 million, depreciation of property and equipment of $15.5 million and an increase in accrued expenses of $33.4 million, as a result of our growing operations. These increases were partially offset by the excess tax benefits from stock-based compensation of $21.3 million, a decrease in deferred revenue of $13.4 million, and the gain on disposal of DVDs of $11.7 million.

Investing activities

Cash used in investing activities during the three months ended September 30, 2007 consisted primarily of purchases of investments in available-for-sale securities of $52.0 million and purchases of content library of $39.5 million. These uses of cash were offset by proceeds from the sale of investments in available-for-sale securities of $41.3 million.

Cash used in investing activities during the nine months ended September 30, 2007 consisted primarily of purchases of investments in available-for-sale securities of $370.1 million and purchases of content library of $165.3 million. These uses of cash were offset by proceeds from the sale of investments in available-for-sale securities of $165.4 million.

Financing activities

Cash used in financing activities during the three and nine months ended September 30, 2007 primarily consisted of stock repurchases of $ 35.3 million and $65.5 million, respectively. This use of cash was offset by an excess tax benefits from stock-based compensation of $5.2 million and $21.3 million, respectively, for the three and nine months ended September 30, 2007.

Contractual Obligations

Off-Balance Sheet Arrangements

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

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Operating Leases

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

In March 2006, we exercised our option to lease a building adjacent to our headquarters in Los Gatos, California for our occupancy following its construction. The building will comprise approximately 80,000 square feet of office space and have an initial term of 5 years. The building is expected to be completed in the first quarter of 2008.

Guarantees - Indemnification Arrangements

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

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

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 allows companies to choose to measure many financial instruments and certain other items at fair value. The statement requires that unrealized gains and losses on items for which the fair value option has been elected to be reported in earnings. SFAS No. 159 also amends certain provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. We do not expect the adoption of this standard to have a material effect on our financial position or results of operations.

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

For financial market risks related to changes in interest rates, reference is made to Item 7A Quantitative and Qualitative Disclosures About Market Risk contained in Part II of our Annual Report on Form 10-K for the year ended December 31, 2006. We started an investment portfolio during the first quarter of 2007 which is comprised of corporate debt securities, government and agency securities and asset and mortgage backed securities. However, our exposure to market risk has not changed materially since December 31, 2006.

Item 4. **Controls and Procedures**

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q were effective in providing reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure.

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

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2007 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. **Legal proceedings**

The information set forth above under Note 8 contained in the Notes to Condensed Consolidated Financial Statements is incorporated herein by reference.

Item 1A. **Risk Factors**

There have been no material changes from risk factors as previously disclosed under the heading Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

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

Stock repurchases during the three months ended September 30, 2007 were as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Dollar Value that May Yet Be Purchased Under the Program (1)
July 1, 2007 - July 31, 2007	399,246	$ 17.37	399,246	$ 62,851,951
August 1, 2007 - August 31, 2007	1,662,441	17.08	1,662,441	34,452,190
September 1, 2007 - September 30, 2007				
Total	2,061,687	$ 17.14	2,061,687	$ 34,452,190

(1) On April 18, 2007, the Company announced a stock repurchase program allowing the Company to repurchase up to $100.0 million of its common stock through the end of 2007. For further information regarding stock repurchase activity, see Note 5 of Notes to Condensed Consolidated Financial Statements in this Quarterly Report.

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Item 6. **Exhibits**

(a) Exhibits:

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

** Indicates a management contract or compensatory plan.

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

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SIGNATURES

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

NETFLIX, INC.

Dated: November 2, 2007 By: /s/ REED HASTINGS
Reed Hastings
Chief Executive Officer
(Principal executive officer)

Dated: November 2, 2007 By: /s/ BARRY MCCARTHY
Barry McCarthy
Chief Financial Officer
(Principal financial and accounting officer)

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