

NETFLIX INC
Form 10-K
February 28, 2008
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 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
(State or other jurisdiction of incorporation or organization)

100 Winchester Circle

Los Gatos, California 95032

(Address and zip code of principal executive offices)

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

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(408) 540-3700

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of Exchange on which registered
Common stock, \$0.001 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of June 30, 2007, the aggregate market value of voting stock held by non-affiliates of the registrant, based upon the closing sales price for the registrant's common stock, as reported in the NASDAQ Global Select Market System, was \$813,946,440. Shares of common stock beneficially owned by each executive officer and director of the Registrant and by each person known by the Registrant to beneficially own 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purposes.

As of February 15, 2008, there were 61,189,772 shares of the registrant's common stock, par value \$0.001, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the registrant's Proxy Statement for Registrant's 2008 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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NETFLIX, INC.

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PART I

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements include, but are not limited to, statements regarding: the growth of our business; growth in online DVD rentals; operating expenses; gross margin; liquidity; developments in Internet delivery of content, our instant-watching feature and DVD formats; revenue per average paying subscriber; impacts relating to our pricing strategy, our content library investments, and fulfillment expenses. These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included throughout this filing and particularly in Item 1A: Risk Factors section set forth in this Annual Report on Form 10-K. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to revise or publicly release any revision to any such forward-looking statement, except as may otherwise be required by law.

Item 1. Business

We are the largest online movie rental subscription service in the United States, providing approximately 7.5 million subscribers access to approximately 90,000 DVD titles plus a growing library of more than 6,000 choices that can be watched instantly on their personal computers, or 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-watching 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.

Our subscription service has grown rapidly since inception. This growth has been fueled by the rapid adoption of DVDs as a medium for home entertainment as well as increased awareness of online DVD rentals. We also believe our growth has been driven by our comprehensive selection of titles, consistently high levels of customer satisfaction and our effective marketing programs. We expect that our business will continue to grow as the market for online DVD rentals continues to grow, a reflection of both the convenience and value of the subscription rental model.

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 high definition successor formats, including 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 of content. In January 2007, we introduced our instant-watching feature for PCs. We intend to broaden the distribution capability of our instant-watching feature to other platforms and partners over time. In January 2008, we announced a development arrangement with LG Electronics. While the terms of this arrangement have not been finalized, we anticipate developing, in conjunction with LG Electronics and other consumer electronics manufacturers, a set-top box device or other devices that will enable our instant-watching feature to be viewed directly on subscribers' televisions.

Our proprietary recommendation service enables us to create a customized store for each subscriber and to generate personalized recommendations which effectively merchandise our comprehensive library of content. We believe that our recommendation technology, based on proprietary algorithms and the approximately 2.0 billion movie ratings collected from our subscribers, enables us to build deep subscriber relationships and maintain a high level of library utilization.

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We promote our service to consumers through various marketing programs, including online promotions, television and radio advertising, package inserts, direct mail and other promotions with third parties. These programs encourage consumers to subscribe to our service and may include a free trial period. At the end of the free trial period, subscribers are automatically enrolled as paying subscribers, unless they cancel their subscription. All paying subscribers are billed monthly in advance.

We stock approximately 90,000 DVD titles. We have established revenue sharing relationships with several studios and distributors. We also purchase titles directly from studios, distributors and other suppliers. In addition, we have more than 6,000 choices available on our Web site for instant-watching.

We ship and receive DVDs throughout the United States. We maintain a nationwide network of shipping centers that allows us to provide fast delivery and return service to our subscribers.

We are focused on growing our subscriber base and revenues and utilizing our proprietary technology to minimize operating costs. Our technology is extensively employed to manage and integrate our business, including our Web site interface, order processing, fulfillment operations and customer service. We believe that our technology also allows us to maximize our library utilization and to run our fulfillment operations in a flexible manner with minimal capital requirements.

We are organized in a single operating segment. All our revenues are generated in the United States, and we have no long-lived assets outside the United States. Substantially all our revenues are derived from monthly subscription fees.

Industry Overview

Filmed entertainment is distributed broadly through a variety of channels, including movie theaters, airlines, hotels and in-home. In-home distribution channels include home video rental and retail outlets, cable and satellite television, pay-per-view, video-on-demand, or VOD, and broadcast television. Currently, studios distribute their filmed entertainment content approximately three to six months after theatrical release to the home video market, four to seven months after theatrical release to pay-per-view and VOD, one year after theatrical release to premium television and two to three years after theatrical release to basic cable and network television. However, in what continues to be an emerging trend, the major studios have shortened the release window on certain titles, in particular the theatrical to home video window. We anticipate that the studios will continue to test a variety of modifications or adjustments to the traditional window, including releasing movies simultaneously on DVD and VOD, but we believe that DVD, and its high definition successors, such as Blu-ray, will continue to receive a preferential distribution window in light of the large profits DVD generates for the studios.

Challenges Faced by Consumers in Selecting In-Home Filmed Entertainment

The proliferation of new releases available for in-home filmed entertainment and the additional demand for back catalog titles on DVD create two primary challenges for consumers in selecting titles.

First, despite the large number of available titles on DVD, existing subscription channels and traditional video rental outlets stock a limited selection of titles, frustrating consumer demand for more choice. Subscription channels, pay-per-view and VOD services continue to offer a relatively narrow selection of titles. Likewise, traditional video rental outlets primarily offer new releases and devote limited space to display and stock back catalog titles. We believe our selection of approximately 90,000 titles on DVD offers an attractive alternative to these traditional channels.

Second, even when consumers have access to the vast number of titles available, they generally have limited means to effectively sort through the titles. We believe our recommendation service and our Web site features provide our subscribers the tools to select titles that appeal to their individual preferences.

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Competitive Strengths

We believe that our revenue and subscriber growth are a result of the following competitive strengths:

Comprehensive Library of Titles. We have developed strategic relationships with top studios and distributors, enabling us to establish and maintain a broad and deep selection of DVD titles. Since our service is available nationally, we believe that we can economically acquire and provide subscribers a broader selection of DVD titles than video rental outlets, video retailers, subscription channels, pay-per-view and VOD services. To maximize our selection of DVD titles, we continuously add newly released DVD titles to our library. Our DVD library contains numerous copies of popular new releases, as well as many DVD titles that appeal to narrow audiences.

Personalized Merchandising. We utilize our proprietary recommendation service to create a custom interface for each subscriber to effectively merchandise our library. Subscribers rate titles on our Web site, and our recommendation service compares these ratings to the database of ratings collected from our entire user base. For each subscriber, these comparisons are used to make predictions about specific titles the subscriber may enjoy. These predictions are used to merchandise titles to subscribers throughout the Web site. As of December 31, 2007, we had approximately 2.0 billion movie ratings in our database. We believe that our recommendation service allows us to create broad-based demand for our library and maximize utilization of each DVD.

Scalable Business Model. We believe that we have a scalable, low-cost business model designed to maximize our revenues and minimize our costs. As we continue to expand our subscriber base, we are able to leverage operational changes in a cost effective manner which further reduces our operating costs on a per subscriber basis. Such cost reductions include increased automation and vendor negotiating leverage. Subscribers' prepaid monthly payments and the recurring nature of our subscription business provide working capital benefits and significant near-term revenue visibility. Our scalable infrastructure and online interface allow us to service our large and expanding subscriber base from a network of low-cost shipping centers.

Convenience, Selection and Fast Delivery. Subscribers can conveniently select titles by building and modifying a personalized queue of titles on our Web site. We create a unique experience for subscribers by serving pages on our Web site that are tailored to subscribers' individual rental and ratings history. Based on each subscriber's queue, we ship DVDs by first class mail. Subscribers return these DVDs to us in prepaid mailers. After receipt of returned DVDs, we mail our subscribers the next available DVD in their queue of selected titles. We have approximately 90,000 DVD titles to choose from, and our nationwide network of distribution centers allows us to offer fast delivery. In addition, we offer subscribers the ability to watch movies instantly on their PCs and anticipate offering this feature on other Netflix-enabled consumer electronics devices.

Growth Strategy

Our strategy to provide a premier filmed entertainment subscription service to our large and growing subscriber base includes the following key elements:

Providing Compelling Value for Subscribers. We provide subscribers access to our comprehensive library of approximately 90,000 DVD titles with no due dates, late fees or shipping charges for a fixed monthly fee. We merchandise titles in easy-to-recognize lists including new releases, by genre and other targeted categories. We also offer more than 6,000 choices through our instant-watching feature. Our convenient, easy-to-use Web site allows subscribers to quickly select current titles, reserve upcoming releases and build an individual queue for future viewing using our proprietary personalization technology. We provide service features to our subscribers that, among other things, enable social networking and further individualization of the service through establishment of sub-account queues and recommendations. Our recommendation service provides subscribers with recommendations of titles from our library. We quickly deliver DVDs to subscribers from our shipping centers located throughout

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the United States by U.S. mail, and we offer certain movies instantly through our instant-watching feature.

Utilizing Technology to Enhance Subscriber Experience and Operate Efficiently. We utilize proprietary technology developed internally to manage the processing and distribution of DVDs from our shipping centers. Our software automates the process of tracking and routing DVDs to and from each of our shipping centers and allocates order responsibilities among them. We continuously monitor, test and seek to improve the efficiency of our distribution, processing and inventory management systems as our subscriber base and shipping volume grows. We operate a nationwide network of shipping centers and continue to develop and grow this network to meet the demands of our operations.

Building Mutually Beneficial Relationships with Filmed Entertainment Providers. We have invested substantial resources in establishing strong ties with various filmed entertainment providers. We maintain an office in Beverly Hills, California that provides us access to the major studios. We acquire content through direct purchases, revenue sharing agreements or license agreements. We work with the content providers to determine which method of acquiring titles is the most beneficial for each party. Our growing subscriber base provides studios with an additional distribution outlet for popular movies and television series, as well as niche titles and programs.

Our Web site www.netflix.com

We have applied substantial resources to plan, develop and maintain proprietary technology to implement the features of our Web site, such as subscription account signup and management, personalized movie merchandising, inventory optimization and customer support. In addition, we offer subscribers the ability to watch certain movies instantly on their PCs and anticipate extending this capability to other Netflix-enabled devices. We also provide our subscribers with the ability to purchase certain previously viewed DVDs.

Our recommendation service uses proprietary algorithms to compare each subscriber's title preferences with preferences of other users contained in our database. This technology enables us to provide personalized movie recommendations unique to each subscriber.

We believe our dynamic store software optimizes subscriber satisfaction and management of our library by integrating the predictions from our recommendation service, each subscriber's current queue and viewing history, inventory levels and other factors to determine which movies to promote to each subscriber.

Our account signup and management tools provide a subscriber interface familiar to online shoppers. We use a real-time postal address validator to help our subscribers enter correct postal addresses and to determine the additional postal address fields required to promote speedy and accurate delivery. Subscribers pay for our service by a credit or debit card. We utilize third party services to authorize and process our payment methods.

Throughout our Web site, we have extensive measurement and testing capabilities, allowing us to continuously optimize our Web site according to our needs, as well as those of our subscribers. We use random control testing extensively, including testing service levels, plans, promotions and pricing.

Our Web site is run on hardware and software co-located at a service provider offering reliable network connections, power, air conditioning and other essential infrastructure. We manage our Web site 24 hours a day, seven days a week. We utilize a variety of proprietary software and freely available and commercially supported tools, integrated in a system designed to rapidly and precisely diagnose and recover from failures. We conduct upgrades and installations of software in a manner designed to minimize disruptions to our subscribers.

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Merchandising

Our merchandising efforts are based on the personal recommendations generated by our recommendation service. All subscribers and site visitors are given many opportunities to rate titles and, as of December 31, 2007, we have collected approximately 2.0 billion ratings. The ratings from our recommendation service help determine which available titles are displayed to a subscriber and in which order. In doing so, we help our subscribers quickly find titles they are more likely to enjoy. Ratings also help determine which available titles are featured most prominently on our Web site in an effort to increase customer satisfaction and selection activity. Finally, data from our recommendation service is used to generate lists of similar titles. Subscribers often start from a familiar title and use our recommendations tool to find other titles they might enjoy. This is a powerful method for catalog browsing and expanding library utilization.

We also provide our subscribers with detailed information about each title in our library which helps them select movies they will enjoy. This information may include:

factual data, including length, rating, cast and crew, special DVD features and screen formats;

movie trailers and other editorial perspectives, including plot synopses and reviews written by our editors, third parties and by other Netflix subscribers; and

data from our recommendation service, including personal rating, average rating and other similar titles the subscriber may enjoy.

Marketing

We use multiple marketing channels through which we attract subscribers to our service. Online advertising is an important channel for acquiring subscribers. We advertise our service online through paid search listings, banner ads, text on popular Web portals and other Web sites and permission based e-mails. In addition, we have an affiliate program whereby we make available Web-based banner ads and other advertisements that third parties may retrieve on a self-assisted basis from our Web site and place on their Web sites. We also advertise our service on various regional and national television and radio stations. We utilize direct mail and print advertising to promote our services in certain consumer packaged goods. We also participate in a variety of cooperative advertising programs with studios under the terms of which we receive cash consideration in exchange for featuring the studios movies in Netflix promotional advertising. We believe that our paid marketing efforts are significantly enhanced by the benefits of word-of-mouth advertising, our subscriber referrals and our active public relations programs.

Content Acquisition

We acquire content through direct purchases, revenue sharing agreements and license agreements.

Under our revenue sharing agreements with studios and distributors, we generally obtain titles for a low initial cost in exchange for a commitment for a defined period of time either to share a percentage of our subscription revenues or to pay a fee based on content utilization. After the revenue sharing period expires for a title, we generally have the option of returning the title to the studio, destroying the title or purchasing the title. The principal structure of each agreement is similar in nature but the specific terms are generally unique to each studio. We also purchase titles from various studios, distributors and other suppliers on a purchase order basis. Under these arrangements, we typically pay a per disc fee for each of the DVDs we purchase. For titles delivered through our instant-watching feature, we generally license the content directly for a period of time. Following expiration of the license term, we are no longer able to distribute the content through our instant-watching feature unless we extend or renew the associated license agreement.

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Fulfillment Operations

We currently stock approximately 90,000 titles on more than 69 million DVDs. We have allocated substantial resources to developing, maintaining and testing the proprietary technology that helps us manage the fulfillment of individual orders and the integration of our Web site, transaction processing systems, fulfillment operations, inventory levels and coordination of our shipping centers.

We ship and receive DVDs from a nationwide network of shipping centers located throughout the United States. We believe our shipping centers allow us to improve the subscription experience for subscribers by shortening the transit time for our DVDs through the U.S. Postal Service. We currently do not ship on weekends or holidays.

Customer Service

We believe that our ability to establish and maintain long-term relationships with subscribers depends, in part, on the strength of our customer support and service operations. Our customer service center is open seven days a week. In 2007, we substantially increased our investment in customer service in order to improve the overall quality and level of service to our subscribers. In addition, we continue to focus on eliminating the causes of customer support calls and providing certain self-service features on our Web site, such as the ability to report and correct most shipping problems. We continue to explore new avenues to deliver efficient problem resolution and feedback channels. Our customer service center is located in Hillsboro, Oregon.

Competition

The market for in-home filmed entertainment is intensely competitive and subject to rapid change. Many consumers maintain simultaneous relationships with multiple in-home filmed entertainment providers and can easily shift spending from one provider to another. For example, consumers may subscribe to HBO, rent a DVD from Blockbuster, buy a DVD from Wal-Mart or Amazon, download a movie from Apple, and subscribe to Netflix, or some combination thereof, all in the same month.

Video rental outlets, retailers and kiosk services with whom we compete include Blockbuster, Movie Gallery, Amazon.com, Wal-Mart Stores, Best Buy and Redbox. We believe that we compete with these video rental outlets and movie retailers primarily on the basis of title selection, convenience and price. We believe that our scalable business model, our subscription service with home delivery and access to our comprehensive library of approximately 90,000 DVD titles compete favorably against traditional video rental outlets and retailers.

We also compete against other online and store-based DVD subscription services, such as Blockbuster's Total Access, subscription entertainment services, such as HBO, Showtime and Starz, pay-per-view and VOD providers and cable and satellite providers.

VOD and delivery of movies over the Internet may also emerge as a competitive distribution channel. Apple's video iPod and Apple TV, Amazon's Unbox and other companies ranging from Google and Yahoo! to Microsoft and Intel are active in Internet delivery of content. Progress in digital delivery, although slow and scattered, continues to be made. VOD for example, is now widely available to digital cable subscribers in major metropolitan areas, such as New York, Boston, Los Angeles and San Francisco. Internet delivery of movies to a computer is currently available from providers, such as iTunes, Hulu, Vongo, Movielink and CinemaNow.

While we anticipate that new devices and services for delivery of content will proliferate over the coming years, we believe that DVD, and its high definition successors, including Blu-ray, will continue to dominate the home entertainment experience in the near term. At some point in the future, digital delivery directly to the home will surpass DVD. Our ability to personalize our library to each subscriber by leveraging our extensive database of user preferences and our strategy of developing a large and growing subscriber base for DVD rentals positions

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us favorably to further develop our digital distribution offering as that market develops. The downloading market is segmented into rental of Internet delivered content, the download-to-own segment and the advertising-supported online delivery segment, and we believe we will lead the rental segment with our instant-watching feature as it develops.

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. Total Access was aggressively priced and experienced rapid subscriber growth and large operating losses in the first half of 2007. In the second half of 2007, Blockbuster adopted a new competitive strategy which emphasized profitable growth. As part of this new strategy, Blockbuster reduced their marketing spending and raised prices on Total Access, which we believe contributed to an acceleration in our subscriber growth.

We believe we are able to provide greater satisfaction for consumers who subscribe to our service due to our focused attention to the business of online subscription rental and the broad and deep selection of DVD titles we offer subscribers. In addition, we have the ability to personalize our library to each subscriber based on their selection history, personal ratings and the tastes and preferences of similar users through our recommendation service and extensive database of user preferences, as well as the ease and speed with which subscribers are able to select, receive and return DVDs.

Employees

As of December 31, 2007, we had 1,542 full-time employees. We also utilize part-time and temporary employees, primarily in our fulfillment operations, to respond to the fluctuating demand for DVD shipments. As of December 31, 2007, we had 1,128 part-time and temporary employees. Our employees are not covered by a collective bargaining agreement, and we consider our relations with our employees to be good.

Intellectual Property

We use a combination of patent, trademark, copyright and trade secret laws and confidentiality agreements to protect our proprietary intellectual property. We have filed patents in the U.S. and abroad. In the U.S., we were issued broad business method patents covering, among other things, our subscription rental service in 2003 and 2006, and we were issued a patent covering our mailing and response envelope in 2005. While our patents are an important element of our business, our business as a whole is not materially dependent on any one or a combination of patents. We have registered trademarks and service marks for the Netflix name and have filed applications for additional trademarks and service marks. Our software, the content of our Web site and other material which we create are protected by copyright. We also protect certain details about our business methods, processes and strategies as trade secrets, and keep confidential information that we believe gives us a competitive advantage.

Our ability to protect and enforce our intellectual property rights is subject to certain risks. Enforcement of intellectual property rights is costly and time consuming. To date, we have relied primarily on proprietary processes and know-how to protect our intellectual property. It is uncertain if and when our other patent and trademark applications may be allowed and whether they will provide us with a competitive advantage.

From time to time, we encounter disputes over rights and obligations concerning intellectual property. We cannot assure that we will prevail in any intellectual property dispute.

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Other Information

We were incorporated in Delaware in August 1997 and completed our initial public offering in May 2002. Our principal executive offices are located at 100 Winchester Circle, Los Gatos, California 95032, and our telephone number is (408) 540-3700. We maintain a Web site at www.netflix.com. The contents of our Web site are not incorporated in, or otherwise to be regarded as part of, this Annual Report on Form 10-K. In this Annual Report on Form 10-K, Netflix, the Company, we, us, our and the registrant refer to Netflix, Inc.

Our investor relations Web site is located at <http://ir.netflix.com>. We make available, free of charge, on our investor relations Web site under SEC Filings, our Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports as soon as reasonably practicable after electronically filing or furnishing those reports to the Securities and Exchange Commission.

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Item 1A. Risk Factors

If any of the following risks actually occurs, our business, financial condition and results of operations could be harmed. In that case, the trading price of our common stock could decline, and you could lose all or part of your investment.

Risks Related to Our Business

If our efforts to attract subscribers are not successful, our revenues will be adversely affected.

We must continue to attract subscribers to our service. Our ability to attract subscribers will depend in part on our ability to consistently provide our subscribers with a valuable and quality experience for selecting, viewing, receiving and returning titles, including providing accurate recommendations through our recommendation service. Furthermore, the relative service levels, pricing and related features of competitors to our service may adversely impact our ability to attract subscribers. Competitors include video retailers, video rental outlets, kiosk services, Internet content providers, including online DVD rental services, cable channels, such as HBO, Showtime and Starz, pay per-view and VOD. If consumers do not perceive our service offering to be of value, or if we introduce new services that are not favorably received by them, we may not be able to attract subscribers. In addition, many of our subscribers are rejoining our service, originate from word-of-mouth advertising and are directly referred to our service from existing subscribers. If our efforts to satisfy our existing subscribers are not successful, we may not be able to attract subscribers, and as a result, our revenues will be adversely affected.

If the market segment for online DVD rentals saturates, our business will be adversely affected.

We have experienced rapid growth of our online DVD rental subscription business since our inception. We have attracted a large number of subscribers who have traditionally used video retailers, video rental outlets, cable channels, pay-per-view and VOD for their in-home filmed entertainment. While the market segment for online DVD rental has grown significantly, we saw our growth slow in 2007. Our slowing growth appears primarily to be the result of the rapid growth of our direct competitor, Blockbuster Online. Even with the apparent reduced competitive threat from Blockbuster Online, our rate of growth may continue to slow. Such slowing growth could indicate that the market segment for online rentals is beginning to saturate. While we believe that online DVD rentals will continue to grow for the foreseeable future, if this market segment were to saturate, our business would be adversely affected.

If we experience excessive rates of churn, our revenues and business will be harmed.

We must minimize the rate of loss of existing subscribers while adding new subscribers. Subscribers cancel their subscription to our service for many reasons, including a perception that they do not use the service sufficiently, delivery takes too long, the service is a poor value, competitive services provide a better value or experience and customer service issues are not satisfactorily resolved. We must continually add new subscribers both to replace subscribers who cancel and to grow our business beyond our current subscriber base. If too many of our subscribers cancel our service, or if we are unable to attract new subscribers in numbers sufficient to grow our business, our operating results will be adversely affected. If we are unable to successfully compete with current and new competitors in both retaining our existing subscribers and attracting new subscribers, our churn will likely increase and our business will be adversely affected. Further, if excessive numbers of subscribers cancel our service, we may be required to incur significantly higher marketing expenditures than we currently anticipate to replace these subscribers with new subscribers.

If we are unable to compete effectively, our business will be adversely affected.

The market for in-home filmed entertainment is intensely competitive and subject to rapid change. New technologies for delivery of in-home filmed entertainment, such as VOD and Internet delivery of content, continue to receive considerable media and investor attention. Many of our competitors have longer operating

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histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. If we are unable to successfully or profitably compete with current and new competitors, programs and technologies, our business will be adversely affected, and we may not be able to increase or maintain market share, revenues or profitability.

In addition, many consumers maintain simultaneous relationships with multiple in-home filmed entertainment providers and can easily shift spending from one provider to another. For example, consumers may subscribe to HBO, rent a DVD from Blockbuster, buy a DVD from Wal-Mart or Amazon, download a movie from Apple and subscribe to Netflix, or some combination thereof, all in the same month. New competitors may be able to launch new businesses at a relatively low cost. DVDs and Internet delivery of content represent only two of many existing and potential new technologies for viewing filmed entertainment. In addition, the growth in adoption of DVD and downloading technology is not mutually exclusive from the growth of other technologies. If we are unable to successfully compete with current and new competitors, programs and technologies, we may not be able to achieve adequate market share, increase our revenues or maintain profitability.

Our principal competitors include:

video rental outlets and kiosk services, such as Blockbuster, Movie Gallery and Redbox;

online DVD subscription rental sites, such as Blockbuster Online;

pay-per-view and VOD services;

movie retail stores, such as Best Buy, Wal-Mart and Amazon.com;

subscription entertainment services, such as HBO, Showtime and Starz;

Internet movie and television content providers, such as iTunes, Amazon.com, Vongo, Hulu, Movielink, and CinemaNow.com;

Internet companies, such as Yahoo! and Google;

cable providers, such as Time Warner and Comcast; and

direct broadcast satellite providers, such as DIRECTV and Echostar.

Some of our competitors have adopted, and may continue to adopt, aggressive pricing policies and devote substantially more resources to marketing, Web site and systems development than we do. There can be no assurance that we will be able to compete effectively against current or new competitors at our existing pricing levels or at even lower price points in the future. Furthermore, we may need to adjust the level of service provided to our subscribers and/or incur significantly higher marketing expenditures than we currently anticipate. As a result of increased competition, we may see a reduction in operating margins and market share.

If VOD or other technologies are more widely adopted and supported as a method of content delivery by the studios and consumers, our business could be adversely affected.

Some digital cable providers and Internet content providers have implemented technology referred to as VOD. This technology transmits movies and other entertainment content on demand with interactive capabilities such as start, stop and rewind. High-speed Internet access has greatly increased the speed and quality of viewing VOD content, including feature-length movies, on personal computers and televisions. In addition,

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other technologies have been developed that allow alternative means for consumers to receive and watch movies or other entertainment, such as on cell phones or other devices such as Apple's video iPod and Apple TV. Although we anticipate providing solutions for the Internet-based delivery of content, as evidenced by our instant-watching feature, VOD or other technologies may become more affordable and viable alternative methods of content delivery that are widely supported by studios and adopted by consumers. If this happens more quickly than we anticipate or more quickly than our own Internet delivery offerings, or if other providers are better able to meet studio and consumer needs and expectations, our business could be adversely affected.

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If the popularity of the DVD format decreases, our business could be adversely affected.

Consumers have rapidly adopted the DVD format for viewing in-home filmed entertainment. While the growth of DVD sales has slowed, we believe that the DVD format, including any successor formats such as Blu-ray, will be valuable long-term consumer propositions and studio profit centers. However, if DVD sales were to decrease, because of a shift away from movie watching or because new or existing technologies were to become more popular at the expense of DVD enjoyment, studios and retailers may reduce their support of the DVD format. Our subscriber growth will be substantially influenced by future popularity of the DVD format, and if such popularity wanes, our subscriber growth may also slow.

If U.S. Copyright law were altered to amend or eliminate the First Sale Doctrine or if studios were to release or distribute titles on DVD in a manner that attempts to circumvent or limit the affects of the First Sale Doctrine, our business could be adversely affected.

Under U.S. Copyright Law, once a copyright owner sells a copy of his work, the copyright owner relinquishes all further rights to sell or otherwise dispose of that copy. While the copyright owner retains the underlying copyright to the expression fixed in the work, the copyright owner gives up his ability to control the fate of the work once it had been sold. As such, once a DVD is sold into the market, those obtaining the DVD are permitted to re-sell it, rent it or otherwise dispose of it. If Congress or the courts were to change or substantially limit this First Sale Doctrine, our ability to obtain content and then rent it could be adversely affected. Likewise, if studios agree to limit the sale or distribution of their content in ways that try to limit the affects of the First Sale Doctrine, our business could be adversely affected. For example, in late 2006 and again in late 2007, Blockbuster announced arrangements with certain content owners pursuant to which Blockbuster would receive content on DVDs for rental exclusively by Blockbuster. To the extent this content is to be distributed exclusively to Blockbuster and not to retail vendors or distributors, we could be prevented from obtaining such content. To the extent the content is also sold to retail vendors or distributors, we would not be prohibited from obtaining and renting such content pursuant to the First Sale Doctrine. Nonetheless, it does impact our ability to obtain such content in the most efficient manner and, in some cases, in sufficient quantity to satisfy demand. If such arrangements were to become more commonplace or if additional impediments to obtaining content were created (such as an exclusive rental window), our ability to obtain content could be impacted and our business could be adversely affected.

We depend on studios to release titles on DVD for an exclusive time period following theatrical release.

Our ability to attract and retain subscribers is related to our ability to offer new releases of filmed entertainment on DVDs prior to their release to other distribution channels. Except for theatrical release, DVDs currently enjoy a significant competitive advantage over other distribution channels, such as pay-per-view and VOD, because of the early distribution window for DVDs. The window for DVD rental and retail sales is generally exclusive against other forms of non-theatrical movie distribution, such as pay-per-view, premium television, basic cable and network and syndicated television. The length of the exclusive window for movie rental and retail sales varies. Our business could suffer increased competition if:

the window for rental were no longer the first following the theatrical release;

the length of this window was shortened; or

the window was not exclusive as to other channels.

The order, length and exclusivity of each window for each distribution channel is determined solely by the studio releasing the title, and we cannot assure you that the studios will not change their policies in the future in a manner that would be adverse to our business and results of operations. Currently, studios distribute their filmed entertainment content approximately three to six months after theatrical release to the home video market, four to seven months after theatrical release to pay-per-view and VOD, one year after theatrical release to premium television and two to three years after theatrical release to basic cable and network television. Over the past

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several years, the major studios have shortened the release window on certain titles, in particular the theatrical to home video window. In addition, some studios have discussed eliminating the exclusive DVD release window on certain titles, in particular releasing movies simultaneously on DVD and VOD.

We depend on studios to license us content for Internet delivery in order to operate our instant-watching feature.

Internet delivery of content involves the licensing of rights which are separate from and independent of the rights we obtain when acquiring DVD content. Our ability to provide our instant-watching feature therefore depends on studios licensing us content specifically for Internet delivery. The license periods and the terms and conditions of such licenses vary by studio. If the studios change their terms and conditions or are no longer willing or able to provide us licenses, our ability to provide Internet delivered content to our subscribers will be adversely affected. Unlike DVD, Internet delivered content is not subject to the First Sale Doctrine. As such we are completely dependent on the studios providing us licenses in order to access and distribute Internet delivered content. In addition, the studios have great flexibility in licensing content. They may elect to license content exclusively to a particular provider or otherwise limit the types of services that can deliver Internet delivered content. For example, HBO licenses content from studios like Warner Bros., and the license provides HBO with the exclusive right to such content against other subscription services, including Netflix. As such, Netflix cannot license certain Warner Bros. content for delivery to its subscribers while Warner Bros. may nonetheless license the same content to transactional VOD providers. This ability to carve-up distribution rights is unique to digital content. If we are unable to secure rights to content and to obtain such content upon terms that are acceptable to us, our ability to operate our instant-watching feature will be adversely impacted, and our subscriber satisfaction with this feature will also be adversely impacted.

We intend to rely on a number of partners to deliver our Internet delivered content to various devices.

We currently offer Internet delivered content only to PCs. We intend to broaden the distribution capability of our instant-watching feature to other platforms and partners over time. In January 2008, we announced our development arrangement with LG Electronics. While the terms of this arrangement have not been finalized, we anticipate developing, in conjunction with LG, a set-top box device that will enable our instant-watching feature to be viewed directly through subscribers' televisions. We intend to enter other deals with additional partners for distribution of our content to various devices. If we are not successful in creating these relationships, or if we encounter technological, content licensing or other impediments, our ability to grow our instant-watching feature could be adversely impacted.

If we experience increased demand for titles which we are unable to offset with increased subscriber retention or operating margins, our operating results may be adversely affected.

With our unlimited plans, there is no established limit to the number of movies that subscribers may rent on DVD or, as we recently announced, watch through our instant-watching feature. We are continually adjusting our service in ways that may impact subscriber movie usage. Such adjustments include new Web site features and merchandising practices, computer-based instant watching of select titles through our instant-watching feature, an expanded DVD distribution network and software and process changes. In addition, demand for titles may increase for a variety of reasons beyond our control, including promotion by studios and seasonal variations or shifts in consumer movie watching.

If our subscriber retention does not increase or our operating margins do not improve to an extent necessary to offset the effect of any increased operating costs associated with increased usage, our operating results will be adversely affected. In addition, our subscriber growth and retention may be adversely affected if we attempt to alter our service or increase our monthly subscription fees to offset any increased costs of acquiring or delivering titles.

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If our subscribers select titles or formats that are more expensive for us to acquire and deliver more frequently, our expenses may increase.

Certain titles cost us more to acquire or result in greater revenue sharing expenses, depending on the source from whom they are acquired and the terms on which they are acquired. If subscribers select these titles more often on a proportional basis compared to all titles selected, our revenue sharing and other content acquisition expenses could increase, and our gross margins could be adversely affected. In addition, films released on the new high definition DVD formats, Blu-ray and HD DVD, and those released for Internet delivery may be more expensive to acquire than in DVD format. The rate of customer acceptance and adoption of these new formats is uncertain. If subscribers select these formats on a proportional basis more often than the existing DVD format, our content acquisition expenses could increase, and our gross margins could be adversely affected.

If our efforts to build strong brand identity and improve subscriber satisfaction and loyalty are not successful, we may not be able to attract or retain subscribers, and our operating results may be adversely affected.

The Netflix brand is still developing, and we must continue to build strong brand identity. To succeed, we must continue to attract and retain a large number of owners of DVD players who have traditionally relied on store-based rental outlets and persuade them to subscribe to our service through our Web site. In addition, we will have to compete for subscribers against other brands which have greater recognition than ours, such as Blockbuster. We believe that the importance of brand loyalty will only increase in light of competition, both for online subscription services and other means of distributing titles, such as VOD. From time to time, our subscribers express dissatisfaction with our service, including among other things, our inventory allocation and delivery processing. To the extent dissatisfaction with our service is widespread or not adequately addressed, our brand may be adversely impacted. If our efforts to promote and maintain our brand are not successful, our operating results and our ability to attract and retain subscribers may be adversely affected.

If we are unable to manage the mix of subscriber acquisition sources, our subscriber levels and marketing expenses may be adversely affected.

We utilize a broad mix of marketing programs to promote our service to potential new subscribers. We obtain new subscribers through our online marketing efforts, including third party banner ads, pop-under placements, direct links and permission-based e-mails, as well as our active affiliate program. In addition, we have engaged in various offline marketing programs, including television and radio advertising, direct mail and print campaigns, consumer package and mailing insertions. We also acquire a number of subscribers who rejoin our service having previously cancelled their membership. We maintain an active public relations program to increase awareness of our service and drive subscriber acquisition. We opportunistically adjust our mix of marketing programs to acquire new subscribers at a reasonable cost with the intention of achieving overall financial goals. If we are unable to maintain or replace our sources of subscribers with similarly effective sources, or if the cost of our existing sources increases, our subscriber levels and marketing expenses may be adversely affected.

If we are unable to continue using our current marketing channels, our ability to attract new subscribers may be adversely affected.

We may not be able to continue to support the marketing of our service by current means if such activities are no longer available to us, become cost prohibitive or are adverse to our business. If companies that currently promote our service decide to enter our business or a similar business or decide to exclusively support our competitors, we may no longer be given access to such channels. In addition, if ad rates increase, we may curtail marketing expenses or otherwise experience an increase in our cost per subscriber. Laws and regulations impose restrictions on the use of certain channels, including commercial e-mail and direct mail. We may limit or discontinue use or support of e-mail and other activities if we become concerned that subscribers or potential subscribers deem such activities intrusive, which could affect our goodwill or brand. If the available marketing channels are curtailed, our ability to attract new subscribers may be adversely affected.

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If we are not able to manage our growth, our business could be adversely affected.

We have expanded rapidly since we launched our Web site in April 1998. Many of our systems and operational practices were implemented when we were at a smaller scale of operations. If we are not able to refine or revise these legacy systems as we grow, if they fail or, if in responding to any other issues related to growth, our management is materially distracted from our current operations, our business may be adversely affected.

We rely heavily on our proprietary technology to process deliveries and returns of our DVDs and to manage other aspects of our operations, including our instant-watching feature, and the failure of this technology to operate effectively could adversely affect our business.

We use complex proprietary software to process deliveries and returns of our DVDs and to manage other aspects of our operations, including our instant-watching feature. Our proprietary technology is intended to allow our nationwide network of shipping centers to be operated on an integrated basis. We continually enhance or modify the software used for our distribution operations. We cannot be sure that any enhancements or other modifications we make to our distribution operations will achieve the intended results or otherwise be of value to our subscribers. Future enhancements and modifications to our proprietary technology could consume considerable resources. If we are unable to maintain and enhance our technology to manage the processing of DVDs among our shipping centers in a timely and efficient manner, our ability to retain existing subscribers and to add new subscribers may be impaired. In addition, through our instant-watching feature, our subscribers will access titles on our Web site through our proprietary movie player software and must maintain their connection to our Web site for an uninterrupted viewing experience. If this proprietary software fails to satisfactorily display the available titles, our ability to retain existing subscribers and to add new subscribers may be impaired. Also, any harm to our subscribers' personal computers caused by the proprietary software could have an adverse effect on our business, results of operations and financial condition.

If we experience delivery problems or if our subscribers or potential subscribers lose confidence in the U.S. mail system, we could lose subscribers, which could adversely affect our operating results.

We rely exclusively on the U.S. Postal Service to deliver DVDs from our shipping centers and to return DVDs to us from our subscribers. We are subject to risks associated with using the public mail system to meet our shipping needs, including delays or disruptions caused by inclement weather, natural disasters, labor activism, health epidemics or bioterrorism. Our DVDs are also subject to risks of breakage during delivery and handling by the U.S. Postal Service. The risk of breakage is also impacted by the materials and methods used to replicate our DVDs. If the entities replicating our DVDs use materials and methods more likely to break during delivery and handling or we fail to timely deliver DVDs to our subscribers, our subscribers could become dissatisfied and cancel our service, which could adversely affect our operating results. In addition, increased breakage rates for our DVDs will increase our cost of acquiring titles.

Increases in the cost of delivering DVDs could adversely affect our gross profit.

Increases in postage delivery rates could adversely affect our gross profit if we elect not to raise our subscription fees to offset the increase. The U.S. Postal Service increased the rate for first class postage on January 8, 2006 by 2 cents, from 37 cents to 39 cents, and then again in May 2007 by another 2 cents. The U.S. Postal Service has announced an increase in the rate for first class postage effective in May 2008 by one cent to 42 cents and it is also expected that the U.S. Postal Service will raise rates again in subsequent years in accordance with the powers recently given the U.S. Postal Service in connection with the postal reform legislation. The U.S. Postal Service continues to focus on plans to reduce its costs and make its service more efficient. If the U.S. Postal Service were to change any policies relative to the requirements of first-class mail, including changes in size, weight or machinability qualifications of our DVD envelopes, such changes could result in increased shipping costs or higher breakage for our DVDs, and our gross margin could be adversely affected. For example, the Office of Inspector General at the U.S. Postal Service recently issued a report

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recommending that the U.S. Postal Service revise the machinability qualifications for first class mail related to DVDs or to charge DVD mailers who don't comply with the new regulations a 17 cent surcharge on all mail deemed unmachinable. We do not currently anticipate any material impact to our operational practices or postage delivery rates arising from this report. Also, if the U.S. Postal Service curtails its services, such as by closing facilities or discontinuing or reducing Saturday delivery service, our ability to timely deliver DVDs could diminish, and our subscriber satisfaction could be adversely affected.

Currently, most filmed entertainment is packaged on a single lightweight DVD. Our delivery process is designed to accommodate the delivery of one DVD to fulfill a selection. Because of the lightweight nature of a DVD, we generally mail one DVD per envelope using standard first class U.S. postage rates. Studios occasionally provide additional content on a second DVD or may package a title on two DVDs. In addition, the studios have begun to release certain films in high definition format on Blu-ray and HD DVDs. These new high definition format DVDs appear to have higher damage rates than regular DVDs. If packaging of filmed entertainment on multiple DVDs were to become more prevalent, if the weight of DVDs were to increase, or the durability of DVDs deteriorate, our costs of delivery and fulfillment processing would increase and our costs of replacing damaged DVDs may rise materially which would depress gross margins and profitability and adversely affect free cash flow.

If we are unable to effectively utilize our recommendation service, our business may suffer.

Based on proprietary algorithms, our recommendation service enables us to predict and recommend titles and effectively merchandise our library to our subscribers. We believe that in order for our recommendation service to function most effectively, it must access a large database of user ratings. We cannot assure that the proprietary algorithms in our recommendation service will continue to function effectively to predict and recommend titles that our subscribers will enjoy, or that we will continue to be successful in enticing subscribers to rate enough titles for our database to effectively predict and recommend new or existing titles.

We are continually refining our recommendation service in an effort to improve its predictive accuracy and usefulness to our subscribers. We may experience difficulties in implementing refinements. In addition, we cannot assure that we will be able to continue to make and implement meaningful refinements to our recommendation service.

If our recommendation service does not enable us to predict and recommend titles that our subscribers will enjoy or if we are unable to implement meaningful improvements, our personal movie recommendation service will be less useful, in which event:

our subscriber satisfaction may decrease, subscribers may perceive our service to be of lower value and our ability to attract and retain subscribers may be adversely affected;

our ability to effectively merchandise and utilize our library will be adversely affected; and

our subscribers may default to choosing titles from among new releases or other titles that cost us more to provide, and our margins may be adversely affected.

If we do not acquire sufficient DVD titles, our subscriber satisfaction and results of operations may be adversely affected.

If we do not acquire sufficient copies of DVDs, either by not correctly anticipating demand or by intentionally acquiring fewer copies than needed to fully satisfy demand, we may not appropriately satisfy subscriber demand, and our subscriber satisfaction and results of operations could be adversely affected. Conversely, if we attempt to mitigate this risk and acquire more copies than needed to satisfy our subscriber demand, our inventory utilization would become less effective and our gross margins would be adversely affected. Our ability to accurately predict subscriber demand as well as market factors such as exclusive distribution arrangements may impact our ability to acquire appropriate quantities of certain DVDs.

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If we are unable to renew or renegotiate our revenue sharing agreements when they expire on terms favorable to us, or if the cost of purchasing titles on a wholesale basis increases, our gross margins may be adversely affected.

We acquire DVDs through a mix of revenue sharing agreements as well as direct purchase arrangements. Whether we enter into a direct purchase or revenue sharing arrangement depends on the economic terms we can negotiate as well as studio preferences. Starting in 2000, we entered into numerous revenue sharing arrangements with studios and distributors which typically enabled us to increase our copy depth of DVDs on an economical basis because of a low initial payment with additional payments made only if our subscribers rent the DVD. During the course of our revenue sharing relationships, various contract administration issues can arise. To the extent that we are unable to resolve any of these issues in an amicable manner, our relationship with the studios and distributors may be adversely impacted.

As the revenue sharing agreements expire, we must renegotiate new terms or shift to direct purchasing arrangements, under which we must pay the full wholesale price regardless of whether the DVD is rented. We have seen the purchase mix shift toward direct purchasing arrangements as revenue sharing agreements expire. If we cannot renegotiate purchasing arrangements on favorable terms, the cost of acquiring content could increase and our gross margins may be adversely affected. In addition, the risk associated with accurately predicting title demand could increase if we are required to directly purchase more titles.

If the sales price of DVDs to retail consumers decreases, our ability to attract new subscribers may be adversely affected.

The cost of manufacturing DVDs is substantially less than the price for which new DVDs are generally sold in the retail market. Thus, we believe that studios and other resellers of DVDs have significant flexibility in pricing DVDs for retail sale. If the retail price of DVDs decreases significantly, consumers may choose to purchase DVDs instead of subscribing to our service.

We may seek additional capital that may result in stockholder dilution or that may have rights senior to those of our common stockholders.

From time to time, we may seek to obtain additional capital, either through equity, equity-linked or debt securities. The decision to obtain additional capital will depend, among other things, on our development efforts, business plans, operating performance and condition of the capital markets. If we raise additional funds through the issuance of equity, equity-linked or debt securities, those securities may have rights, preferences or privileges senior to the rights of our common stock, and our stockholders may experience dilution.

Any significant disruption in service on our Web site or in our computer systems could result in a loss of subscribers.

Subscribers and potential subscribers access our service through our Web site, where the title selection process is integrated with our delivery processing systems and software. Our reputation and ability to attract, retain and serve our subscribers is dependent upon the reliable performance of our Web site, network infrastructure and fulfillment processes. Interruptions in these systems could make our Web site unavailable and hinder our ability to fulfill selections. Much of our software is proprietary, and we rely on the expertise of our engineering and software development teams for the continued performance of our software and computer systems. In addition, through our instant-watching feature, our subscribers access titles on our Web site through our proprietary movie player software and must maintain their connection to our Web site for an uninterrupted viewing experience. Service interruptions, errors in our software or the unavailability of our Web site could diminish the overall attractiveness of our subscription service to existing and potential subscribers.

Our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions and delays in our service and operations as well as loss, misuse or theft of data. Our Web site periodically experiences directed attacks intended to cause a disruption in service. Any attempts by

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hackers to disrupt our Web site service or our internal systems, if successful, could harm our business, be expensive to remedy and damage our reputation. Our insurance does not cover expenses related to direct attacks on our Web site or internal systems. Efforts to prevent hackers from entering our computer systems are expensive to implement and may limit the functionality of our services. Any significant disruption to our Web site or internal computer systems could result in a loss of subscribers and adversely affect our business and results of operations.

Our communications hardware and the computer hardware used to operate our Web site and our Internet-based delivery of content are hosted at the facilities of a third party provider. Hardware for our delivery systems is maintained in our shipping centers. Fires, floods, earthquakes, power losses, telecommunications failures, break-ins and similar events could damage these systems and hardware or cause them to fail completely. As we do not maintain entirely redundant systems, a disrupting event could result in prolonged downtime of our operations and could adversely affect our business. Problems faced by our third party Web hosting provider, with the telecommunications network providers with whom it contracts or with the systems by which it allocates capacity among its customers, including us, could adversely impact the experience of our subscribers.

Our executive offices and our Sunnyvale-based shipping center are located in the San Francisco Bay Area. In the event of an earthquake or other natural or man-made disaster, our operations would be adversely affected.

Our executive offices and our Sunnyvale-based shipping center are located in the San Francisco Bay Area. Our business and operations could be adversely affected in the event of electrical blackouts, fires, floods, earthquakes, power losses, telecommunications failures, break-ins or similar events. We may not be able to effectively shift our fulfillment and delivery operations due to disruptions in service in the San Francisco Bay Area or any other facility. Because the San Francisco Bay Area is located in an earthquake-sensitive area, we are particularly susceptible to the risk of damage to, or total destruction of, our Sunnyvale-based operations center and the surrounding transportation infrastructure. We are not insured against any losses or expenses that arise from a disruption to our business due to earthquakes.

The loss of our Chief Executive Officer, Chief Financial Officer or Chief Marketing Officer, or our failure to attract, assimilate and retain other highly qualified personnel in the future could harm our business and new service developments.

We depend on the continued services and performance of our key personnel, including Reed Hastings, our Chief Executive Officer, President and Chairman of the Board, Barry McCarthy, our Chief Financial Officer and Leslie J. Kilgore, our Chief Marketing Officer. In addition, much of our key technology and systems are custom-made for our business by our personnel. The loss of key personnel could disrupt our operations and have an adverse effect on our ability to grow our business.

Privacy concerns could limit our ability to leverage our subscriber data.

In the ordinary course of business and in particular in connection with providing our personal movie recommendation service, we collect and utilize data supplied by our subscribers. We currently face certain legal obligations regarding the manner in which we treat such information. Other businesses have been criticized by privacy groups and governmental bodies for attempts to link personal identities and other information to data collected on the Internet regarding users' browsing and other habits. Increased regulation of data utilization practices, including self-regulation as well as increased enforcement of existing laws, could have an adverse effect on our business.

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Our reputation and relationships with subscribers would be harmed if our billing data were to be accessed by unauthorized persons.