NETFLIX INC
Form 10-K
January 29, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2014

OR

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

For the transition period from to

Commission File Number: 000-49802

Netflix, Inc.
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Delaware | 001-35727 |
| (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)

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 | NASDAQ Stock Market LLC (NASDAQ Global Select Market) |

Securities registered pursuant to Section 12(g) of the Act: None

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

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 o No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark 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.o

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

| | | | |
|---|---|---|---|
| Large accelerated filer x | Accelerated filer o | Non-accelerated filer o (do not check if smaller reporting company) | Smaller reporting company o |

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

As of June 30, 2014, 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 $25,313,674,160. 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 purpose.

As of January 28, 2015, there were 60,498,082 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 2015 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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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: our core strategy; the growth of Internet delivery of content; the growth in our streaming memberships; the decline in our DVD memberships and the resources allocated to our DVD segment; the market opportunity for streaming content; contribution margins; contribution profits (losses); liquidity; free cash flows; revenues; net income; legal costs; operating cash flows; stock price volatility; membership growth rates; timing of facilities construction; nature of our content agreements; member viewing habits; payment of future dividends; obtaining additional capital; our content library and marketing investments, including investments in original programming; significance of future contractual obligations; realization of deferred tax assets; seasonality; method of content delivery; and international expansion. 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

ABOUT US

Netflix, Inc. (“Netflix”, “the Company”, “we”, or “us”) is the world’s leading Internet television network with over 57 million streaming members in nearly 50 countries enjoying more than two billion hours of TV shows and movies per month, including original series, documentaries and feature films. Our members can watch as much as they want, anytime, anywhere, on nearly any Internet-connected screen. Members can play, pause and resume watching, all without commercials or commitments. Additionally, in the United States ("U.S."), our members can receive DVDs delivered quickly to their homes.

We are a pioneer in the Internet delivery of TV shows and movies, launching our streaming service in 2007. Since this launch, we have developed an ecosystem for Internet-connected screens and have licensed and acquired increasing amounts of content that enable consumers to enjoy TV shows and movies directly on their TVs, computers and mobile devices. As a result of these efforts, we have experienced growing consumer acceptance of, and interest in, the delivery of TV shows and movies directly over the Internet.

Our core strategy is to grow our streaming membership business globally within the parameters of our consolidated net income and operating segment contribution profit (loss) targets. We are continuously improving our members' experience by expanding our streaming content with a focus on a programming mix of content that delights our members. We are continually enhancing our user interface and extending our streaming service to even more Internet-connected screens.

We continue to grow our streaming service both domestically and internationally. We began our international expansion with Canada in 2010 and have since launched our service in Latin America and several European countries. We have also expanded our streaming content offering to include more exclusive and original programming, including several Emmy, Golden Globe and Academy Award nominated original series and documentaries.

Prior to July 2011, in the U.S., our streaming and DVD-by-mail operations were combined and members could receive both streaming content and DVDs under a single “hybrid” plan. In July 2011, we separated the combined plans, making it necessary for members who wish to receive both DVDs-by-mail and streaming content to have two separate membership plans.

BUSINESS SEGMENTS

The Company has three reportable segments: Domestic streaming, International streaming and Domestic DVD. The Domestic and International streaming segments derive revenues from monthly membership fees for services consisting solely of streaming content. The Domestic DVD segment derives revenues from monthly membership fees for services consisting solely of DVD-by-mail. For additional information regarding our segments, including information about our financial results by geography, see Note 12 of Item 8, Financial Statements and Supplementary Data.

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## COMPETITION

The market for entertainment video is intensely competitive and subject to rapid change. We compete against other entertainment video providers, such as multichannel video programming distributors ("MVPDs"), Internet-based movie and TV content providers (including those that provide pirated content) and DVD rental outlets and more broadly against other sources of entertainment that our members could choose in their moments of free time. We also compete against entertainment video providers in obtaining content that our members love, both for licensed streaming content and for original content projects.

While consumers may maintain simultaneous relationships with multiple entertainment sources, we strive for consumers to choose us in their moments of free time. We have often referred to this choice as our objective of "winning moments of truth." In attempting to win these moments of truth with our members, we are continually improving our service, including both our technology and our content, which is increasingly exclusive and curated, including our own original programming.

## SEASONALITY

Our member growth exhibits a seasonal pattern that reflects variations when consumers buy Internet-connected devices and when they tend to increase their viewing. Our domestic member growth is generally greatest in our fourth and first quarters (October through March), slowing in our second quarter (April through June) and then accelerating in our third quarter (July through September). We expect each market in our International Steaming segment to demonstrate more predictable seasonal patterns as our service offering in each market becomes more established and we have a longer history to assess such patterns. Additionally, the variable expenses associated with shipments of DVDs are highest in the first quarter due to the seasonal nature of DVD usage.

## INTELLECTUAL PROPERTY

We regard our trademarks, service marks, copyrights, patents, domain names, trade dress, trade secrets, proprietary technologies and similar intellectual property as important to our success. We use a combination of patent, trademark, copyright and trade secret laws and confidentiality agreements to protect our proprietary intellectual property. Our ability to protect and enforce our intellectual property rights is subject to certain risks and from time to time we encounter disputes over rights and obligations concerning intellectual property. We cannot provide assurance that we will prevail in any intellectual property disputes.

## EMPLOYEES

As of December 31, 2014, we had 2,189 full-time employees. We also utilize part-time and temporary employees, primarily in our DVD fulfillment operations, to respond to the fluctuating demand for DVD shipments. As of December 31, 2014, we had 261 part-time and temporary employees. Our employees are not covered by collective bargaining agreements, however, to the extent we develop and produce our own content, certain employees of affiliated entities may be covered by such agreements, including certain writers, directors, actors and production personnel.

## 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. We make available, free of charge on our web site, access to our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as soon as reasonably practicable after we file or furnish them electronically with the Securities and Exchange Commission ("SEC").

Investors and others should note that we announce material financial information to our investors using our investor relations website (http://ir.netflix.com), SEC filings, press releases, public conference calls and webcasts. We use these channels as well as social media to communicate with our members and the public about our company, our services and other issues. It is possible that the information we post on social media could be deemed to be material information. Therefore, we encourage investors, the media, and others interested in our company to review the information we post on the social media channels listed on our investor relations website.

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## Item 1A. Risk Factors

If any of the following risks actually occur, 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 and retain members are not successful, our business will be adversely affected.

We have experienced significant member growth over the past several years. Our ability to continue to attract members will depend in part on our ability to consistently provide our members with compelling content choices, as well as a quality experience for selecting and viewing TV shows and movies. Furthermore, the relative service levels, content offerings, pricing and related features of competitors to our service may adversely impact our ability to attract and retain members. Competitors include other entertainment video providers, such as MVPDs, Internet-based movie and TV content providers (including those that provide pirated content) and DVD rental outlets. If consumers do not perceive our service offering to be of value, including if we introduce new or adjust existing features, adjust pricing or service offerings, or change the mix of content in a manner that is not favorably received by them, we may not be able to attract and retain members. In addition, many of our members are rejoining our service or originate from word-of-mouth advertising from existing members. If our efforts to satisfy our existing members are not successful, we may not be able to attract members, and as a result, our ability to maintain and/or grow our business will be adversely affected. Members cancel our service for many reasons, including a perception that they do not use the service sufficiently, the need to cut household expenses, availability of content is unsatisfactory, competitive services provide a better value or experience and customer service issues are not satisfactorily resolved. We must continually add new members both to replace members who cancel and to grow our business beyond our current member base. If growth rates slow faster than expected, given, in particular that our content costs are largely fixed in nature and contracted over several years, we may not be able to adjust our expenditures or increase our (per member) revenues commensurate with the lowered growth rate such that our margins, liquidity and results of operation may be adversely impacted. If we are unable to successfully compete with current and new competitors in both retaining our existing members and attracting new members, our business will be adversely affected. Further, if excessive numbers of members cancel our service, we may be required to incur significantly higher marketing expenditures than we currently anticipate to replace these members with new members.

Changes in competitive offerings for entertainment video, including the potential rapid adoption of piracy-based video offerings, could adversely impact our business.

The market for entertainment video is intensely competitive and subject to rapid change. Through new and existing distribution channels, consumers have increasing options to access entertainment video. The various economic models underlying these channels include subscription, transactional, ad-supported and piracy-based models. All of these have the potential to capture meaningful segments of the entertainment video market. Piracy, in particular, threatens to damage our business, as its fundamental proposition to consumers is so compelling and difficult to compete against: virtually all content for free. Furthermore, in light of the compelling consumer proposition, piracy services are subject to rapid global growth. Traditional providers of entertainment video, including broadcasters and cable network operators, as well as Internet based e-commerce or entertainment video providers are increasing their Internet-based video offerings. Several of these competitors have long operating histories, large customer bases, strong brand recognition and significant financial, marketing and other resources. They may secure better terms from suppliers, adopt more aggressive pricing and devote more resources to product development, technology, infrastructure, content acquisitions and marketing. New entrants may enter the market or existing providers may adjust their services with unique offerings or approaches to providing entertainment video. Companies also may enter into business combinations or alliances that strengthen their competitive positions. If we are unable to successfully or profitably compete with current and new competitors, our business will be adversely affected, and we may not be able to increase or maintain market share, revenues or profitability.

The long-term and fixed cost nature of our content commitments may limit our operating flexibility and could adversely affect our liquidity and results of operations.

In connection with obtaining streaming content, we typically enter into multi-year commitments with studios and other content providers, the payment terms of which are not tied to member usage or the size of our member base ("fixed cost") but which may be tied to such factors as titles licensed and/or theatrical exhibition receipts. Such commitments are included in the Contractual Obligations section of Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 6, Commitments and Contingencies in Item 8. Given the multiple-year duration and largely fixed cost nature of content commitments, if member acquisition and retention do not meet our expectations, our margins may be adversely impacted. Payment terms for certain content commitments, such as programming that is initially available in the

applicable territory on our service (“original programming”), will typically require more up-front cash payments than other licensing agreements. To the extent member and/or revenue growth do not meet our expectations, our liquidity and results of operations could be adversely affected as a result of content commitments and accelerated payment requirements of certain agreements. In addition, the long-term and fixed cost nature of our content commitments may limit our flexibility in planning for, or reacting to changes in our business and the market segments in which we operate. As we expand internationally, we must license content in advance of entering into a new geographical market. If we license content that is not favorably received by consumers in the applicable territory, acquisition and retention may be adversely impacted and given the long-term and fixed cost nature of our content commitments, we may not be able to adjust our content offering quickly and our results of operation may be adversely impacted.
We are devoting more resources toward the development, production, marketing and distribution of original programming, including TV series and movies. We believe that original programming can help differentiate our service from other offerings, enhance our brand and otherwise attract and retain members. To the extent our original programming does not meet our expectations, in particular, in terms of costs, viewing and popularity, our business, including our brand and results of operations may be adversely impacted.
If we are not able to manage change and growth, our business could be adversely affected.
We are expanding our operations internationally, scaling our streaming service to effectively and reliably handle anticipated growth in both members and features related to our service, as well as continuing to operate our DVD service within the U.S. As we expand internationally, we are managing our business to address varied content offerings, consumer customs and practices, in particular those dealing with e-commerce and Internet video, as well as differing legal and regulatory environments. As we scale our streaming service, we are developing technology and utilizing third-party “cloud” computing services. If we are not able to manage the growing complexity of our business, including improving, refining or revising our systems and operational practices related to our streaming operations, our business may be adversely affected.
If we fail to maintain or, in new markets establish, a positive reputation with consumers concerning our service, including the content we offer, we may not be able to attract or retain members, and our operating results may be adversely affected.
We believe that a positive reputation with consumers concerning our service is important in attracting and retaining members who have a number of choices from which to obtain entertainment video. To the extent our content, in particular, our original programming, is perceived as low quality, offensive or otherwise not compelling to consumers, our ability to establish and maintain a positive reputation may be adversely impacted. Furthermore, to the extent our marketing, customer service and public relations efforts are not effective or result in negative consumer reaction, our ability to establish and maintain a positive reputation may likewise be adversely impacted. As we expand into new markets, we will also need to establish our reputation with consumers and to the extent we are not successful in creating positive impressions, our business in these new markets may be adversely impacted.
Changes in how we market our service could adversely affect our marketing expenses and member levels may be adversely affected.
We utilize a broad mix of marketing and public relations programs, including social media sites such as Facebook and Twitter, to promote our service to potential new members. We may limit or discontinue use or support of certain marketing sources or activities if advertising rates increase or if we become concerned that members or potential members deem certain marketing practices intrusive or damaging to our brand. If the available marketing channels are curtailed, our ability to attract new members may be adversely affected.
If companies that promote our service decide that we negatively impact their business, that they want to compete more directly with our business or enter a similar business or decide to exclusively support our competitors, we may no longer have access to such marketing channels. We also acquire a number of members who rejoin our service having previously cancelled their membership. If we are unable to maintain or replace our sources of members with similarly effective sources, or if the cost of our existing sources increases, our member levels and marketing expenses may be adversely affected
We face risks, such as unforeseen costs and potential liability in connection with content we develop, produce, license and/or distribute through our service.

As a distributor of content, we face potential liability for negligence, copyright and trademark infringement, or other claims based on the nature and content of materials that we produce, license and/or distribute. We also may face potential liability for content used in promoting our service, including marketing materials and features on our website such as member reviews. As we expand our original programming, we will become responsible for production costs and other expenses, such as ongoing guild payments. We will also take on risks associated with production, such as completion and key talent risk. To

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the extent we do not accurately anticipate costs or mitigate risks, including for content that we obtain but ultimately does not appear on our service, or if we become liable for content we develop, produce, license and/or distribute, our business may suffer. Litigation to defend these claims could be costly and the expenses and damages arising from any liability or unforeseen production risks could harm our results of operations. We may not be indemnified against claims or costs of these types and we may not have insurance coverage for these types of claims.

If studios, content providers or other rights holders refuse to license streaming content or other rights upon terms acceptable to us, our business could be adversely affected.

Our ability to provide our members with content they can watch depends on studios, content providers and other rights holders licensing rights to distribute such content and certain related elements thereof, such as the public performance of music contained within the content we distribute. The license periods and the terms and conditions of such licenses vary. If the studios, content providers and other rights holders are not or are no longer willing or able to license us content upon terms acceptable to us, our ability to stream content to our members will be adversely affected and/or our costs could increase. Many of the licenses for content provide for the studios or other content providers to withdraw content from our service relatively quickly. Because of these provisions as well as other actions we may take, content available through our service can be withdrawn on short notice. As competition increases, we may see the cost of programming increase. As we seek to differentiate our service, we are increasingly focused on securing certain exclusive rights when obtaining content, including original content. We are also focused on programming an overall mix of content that delights our members in a cost efficient manner. Within this context, we are selective about the titles we add and renew to our service. If we do not maintain a compelling mix of content, our member acquisition and retention may be adversely affected.

Music contained within content we distribute may require us to obtain licenses for such distribution. In this regard, we engage in negotiations with performing rights organizations and collection societies (“PROs”) that hold certain rights to music interests in connection with streaming content into various territories. If we are unable to reach mutually acceptable terms with these organizations, we could become involved in litigation and/or could be enjoined from distributing certain content, which could adversely impact our business. Additionally, pending and ongoing litigation as well as negotiations between certain PROs and other third parties in various territories could adversely impact our negotiations with PROs, or result in music publishers represented by certain PROs unilaterally withdrawing rights, and thereby adversely impact our ability to reach licensing agreements reasonably acceptable to us. Failure to reach such licensing agreements could expose us to potential liability for copyright infringement or otherwise increase our costs.

We rely upon a number of partners to make our service available on their devices.

We currently offer members the ability to receive streaming content through a host of Internet-connected devices, including TVs, digital video players, television set-top boxes and mobile devices. We have agreements with various cable, satellite and telecommunications operators to make our service available through the television set-top boxes of these service providers.  We intend to continue to broaden our capability to instantly stream TV shows and movies to other platforms and partners over time. If we are not successful in maintaining existing and creating new relationships, or if we encounter technological, content licensing or other impediments to delivering our streaming content to our members via these devices, our ability to grow our business could be adversely impacted. Our agreements with our device partners are typically between one and three years in duration and our business could be adversely affected if, upon expiration, a number of our partners do not continue to provide access to our service or are unwilling to do so on terms acceptable to us, which terms may include the degree of accessibility and prominence of our service. Furthermore, devices are manufactured and sold by entities other than Netflix and while these entities should be responsible for the devices' performance, the connection between these devices and Netflix may nonetheless result in consumer dissatisfaction toward Netflix and such dissatisfaction could result in claims against us or otherwise adversely impact our business. In addition, technology changes to our streaming functionality may require that partners update their devices. If partners do not update or otherwise modify their devices, our service and our members' use and enjoyment could be negatively impacted.

Any significant disruption in or unauthorized access to our computer systems or those of third parties that we utilize in our operations, including those relating to cybersecurity or arising from cyber attacks, could result in a loss or degradation of service, unauthorized disclosure of data, including both member and corporate information, and could adversely impact our business.

Our reputation and ability to attract, retain and serve our members is dependent upon the reliable performance and security of our computer systems and those of third parties that we utilize in our operations. These systems may be subject to damage or interruption from earthquakes, adverse weather conditions, other natural disasters, terrorist attacks, power loss, telecommunications failures, and cybersecurity risks. Interruptions in these systems, or with the Internet in general, could make our service unavailable or degraded or otherwise hinder our ability to deliver streaming content or fulfill DVD selections.

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Service interruptions, errors in our software or the unavailability of computer systems used in our operations could diminish the overall attractiveness of our membership service to existing and potential members.

Our computer systems and those of third parties we use in our operations are vulnerable to cybersecurity risks, including cyber attacks such as computer viruses, denial of service attacks, physical or electronic break-ins and similar disruptions. These systems periodically experience directed attacks intended to lead to interruptions and delays in our service and operations as well as loss, misuse or theft of data. Any attempt by hackers to obtain our data, disrupt our service, or otherwise access our systems, or those of third parties we use, if successful, could harm our business, be expensive to remedy and damage our reputation. We have implemented certain systems and processes to thwart hackers and protect our data and systems. To date hackers have not had a material impact on our service or systems however this is no assurance that hackers may not be successful in the future. Our insurance does not cover expenses related to such disruptions or unauthorized access. Efforts to prevent hackers from disrupting our service or otherwise accessing our systems are expensive to implement and may limit the functionality of or otherwise negatively impact our service offering and systems. Any significant disruption to our service or access to our systems could result in a loss of members and adversely affect our business and results of operation.

We utilize our own communications and computer hardware systems located either in our facilities or in that of a third-party Web hosting provider. In addition, we utilize third-party “cloud” computing services in connection with our business operations. We also utilize our own and third-party content delivery networks to help us stream TV shows and movies in high volume to Netflix members over the Internet. Problems faced by us or our third-party Web hosting, "cloud" computing, or content delivery network providers, including technological or business-related disruptions, as well as cybersecurity threats, could adversely impact the experience of our members.

We rely upon Amazon Web Services to operate certain aspects of our service and any disruption of or interference with our use of the Amazon Web Services operation would impact our operations and our business would be adversely impacted.

Amazon Web Services ("AWS") provides a distributed computing infrastructure platform for business operations, or what is commonly referred to as a "cloud" computing service. We have architected our software and computer systems so as to utilize data processing, storage capabilities and other services provided by AWS. Currently, we run the vast majority of our computing on AWS. Given this, along with the fact that we cannot easily switch our AWS operations to another cloud provider, any disruption of or interference with our use of AWS would impact our operations and our business would be adversely impacted. While the retail side of Amazon competes with us, we do not believe that Amazon will use the AWS operation in such a manner as to gain competitive advantage against our service.

If the technology we use in operating our business fails, is unavailable, or does not operate to expectations, our business and results of operation could be adversely impacted.

We utilize a combination of proprietary and third party technology to operate our business. This includes the technology that we have developed to recommend and merchandise content to our consumers as well as enable fast and efficient delivery of content to our members and their various consumer electronic devices. For example, we have built and deployed our own content-delivery network (“CDN”). To the extent Internet Service Providers ("ISPs") do not interconnect with our CDN or if we experience difficulties in its operation, our ability to efficiently and effectively deliver our streaming content to our members could be adversely impacted and our business and results of operation could be adversely affected. Likewise, if our recommendation and merchandising technology does not enable us to predict and recommend titles that our members will enjoy, our ability to attract and retain members may be adversely affected. We also utilize third party technology to help market our service, process payments, and otherwise manage the daily operations of our business. If our technology or that of third parties we utilize in our operations fails or otherwise operates improperly, our ability to operate our service, retain existing members and add new members may be impaired. Also, any harm to our members' personal computers or other devices caused by software used in our operations could have an adverse effect on our business, results of operations and financial condition.

If government regulations relating to the Internet or other areas of our business change, we may need to alter the manner in which we conduct our business, or incur greater operating expenses.

The adoption or modification of laws or regulations relating to the Internet or other areas of our business could limit or otherwise adversely affect the manner in which we currently conduct our business. In addition, the continued growth and development of the market for online commerce may lead to more stringent consumer protection laws, which may impose additional burdens on us. If we are required to comply with new regulations or legislation or new interpretations of existing regulations or legislation, this compliance could cause us to incur additional expenses or alter our business model.

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Changes in laws or regulations that adversely affect the growth, popularity or use of the Internet, including laws impacting net neutrality, could decrease the demand for our service and increase our cost of doing business. The failure to adopt laws protecting strong net neutrality could also increase the cost of doing business. For example, in late 2010, the Federal Communications Commission ("FCC") adopted net neutrality rules intended, in part, to prevent network operators from discriminating against legal traffic that transverse their networks. The U.S. Court of Appeals for the District of Columbia subsequently struck down the FCC’s net neutrality rules and it is currently uncertain how the FCC will respond to this decision. To the extent network operators attempt to use this ruling to extract fees from us to deliver our traffic or otherwise engage in discriminatory practices, our business could be adversely impacted. As we expand internationally, government regulations concerning the Internet, in particular net neutrality, may be nascent or non-existent. Within such a regulatory environment, coupled with potentially significant political and economic power of local network operators, we could experience discriminatory or anti-competitive practices that could impede our growth, cause us to incur additional expense or otherwise negatively affect our business.

Changes in how network operators handle and charge for access to data that travel across their networks could adversely impact our business.

We rely upon the ability of consumers to access our service through the Internet. To the extent that network operators implement usage based pricing, including meaningful bandwidth caps, or otherwise try to monetize access to their networks by data providers, we could incur greater operating expenses and our member acquisition and retention could be negatively impacted. Furthermore, to the extent network operators create tiers of Internet access service and either charge us for or prohibit us from being available through these tiers, our business could be negatively impacted.

Most network operators that provide consumers with access to the Internet also provide these consumers with multichannel video programming. As such, many network operators have an incentive to use their network infrastructure in a manner adverse to our continued growth and success. For example, Comcast exempted certain of its own Internet video traffic (e.g., Streampix videos to the Xbox 360) from a bandwidth cap that applies to all unaffiliated Internet video traffic (e.g., Netflix videos to the Xbox 360). While we believe that consumer demand, regulatory oversight and competition will help check these incentives, to the extent that network operators are able to provide preferential treatment to their data as opposed to ours or otherwise implement discriminatory network management practices, our business could be negatively impacted. In some international markets, these same incentives apply however, the consumer demand, regulatory oversight and competition may not be as strong as in our domestic market.

Privacy concerns could limit our ability to collect and leverage our member data and disclosure of member data could adversely impact our business and reputation.

In the ordinary course of business and in particular in connection with merchandising our service to our members, we collect and utilize data supplied by our members. 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 or findings under existing laws, that limit our ability to collect and use data, could have an adverse effect on our business. In addition, if we were to disclose data about our members in a manner that was objectionable to them, our business reputation could be adversely affected, and we could face potential legal claims that could impact our operating results. As our business evolves and as we expand internationally, we may become subject to additional and/or more stringent legal obligations concerning our treatment of customer information. Failure to comply with these obligations could subject us to liability, and to the extent that we need to alter our business model or practices to adapt to these obligations, we could incur additional expenses.

Our reputation and relationships with members would be harmed if our member data, particularly billing data, were to be accessed by unauthorized persons.

We maintain personal data regarding our members, including names and billing data. This data is maintained on our own systems as well as that of third parties we use in our operations. With respect to billing data, such as credit card numbers, we rely on licensed encryption and authentication technology to secure such information. We take measures to protect against unauthorized intrusion into our members' data. Despite these measures we, our payment processing services or other third party services we use such as AWS, could experience an unauthorized intrusion into our members' data. In the event of such a breach, current and potential members may become unwilling to provide the information to us necessary for them to become members. Additionally, we could face legal claims for such a breach. The costs relating to any data breach could be material, and we currently do not carry insurance against the risk of a data breach. For these reasons, should an unauthorized intrusion into our members’ data occur, our business could be adversely affected.

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We are subject to payment processing risk
Our members pay for our service using a variety of different payment methods, including credit and debit cards, gift subscriptions and direct debit. We rely on internal systems as well as those of third parties to process payment. Acceptance and processing of these payment methods are subject to certain rules and regulations and require payment of interchange and other fees. To the extent there are disruptions in our payment processing systems, increases in payment processing fees and/or changes to rules or regulations concerning payment processing, our revenue, operating expenses and results of operation could be adversely impacted. In addition, from time to time, we encounter fraudulent use of payment methods, which could impact our results of operation and if not adequately controlled and managed could create negative consumer perceptions of our service.
If our trademarks and other proprietary rights are not adequately protected to prevent use or appropriation by our competitors, the value of our brand and other intangible assets may be diminished, and our business may be adversely affected.
We rely and expect to continue to rely on a combination of confidentiality and license agreements with our employees, consultants and third parties with whom we have relationships, as well as trademark, copyright, patent and trade secret protection laws, to protect our proprietary rights. We may also seek to enforce our proprietary rights through court proceedings. We have filed and we expect to file from time to time for trademark and patent applications. Nevertheless, these applications may not be approved, third parties may challenge any copyrights, patents or trademarks issued to or held by us, third parties may knowingly or unknowingly infringe our intellectual property rights, and we may not be able to prevent infringement or misappropriation without substantial expense to us. If the protection of our intellectual property rights is inadequate to prevent use or misappropriation by third parties, the value of our brand and other intangible assets may be diminished, competitors may be able to more effectively mimic our service and methods of operations, the perception of our business and service to members and potential members may become confused in the marketplace, and our ability to attract members may be adversely affected.
We currently hold various domain names relating to our brand, including Netflix.com. Failure to protect our domain names could adversely affect our reputation and brand and make it more difficult for users to find our Web site and our service. We may be unable, without significant cost or at all, to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our trademarks and other proprietary rights.
Intellectual property claims against us could be costly and result in the loss of significant rights related to, among other things, our Web site, streaming technology, our recommendation and merchandising technology, title selection processes and marketing activities.
Trademark, copyright, patent and other intellectual property rights are important to us and other companies. Our intellectual property rights extend to our technology, business processes and the content on our Web site. We use the intellectual property of third parties in merchandising our products and marketing our service through contractual and other rights. From time to time, third parties allege that we have violated their intellectual property rights. If we are unable to obtain sufficient rights, successfully defend our use, or develop non-infringing technology or otherwise alter our business practices on a timely basis in response to claims against us for infringement, misappropriation, misuse or other violation of third-party intellectual property rights, our business and competitive position may be adversely affected. Many companies are devoting significant resources to developing patents that could potentially affect many aspects of our business. There are numerous patents that broadly claim means and methods of conducting business on the Internet. We have not searched patents relative to our technology. Defending ourselves against intellectual property claims, whether they are with or without merit or are determined in our favor, results in costly litigation and diversion of technical and management personnel. It also may result in our inability to use our current Web site, streaming technology, our recommendation and merchandising technology or inability to market our service or merchandise our products. As a result of a dispute, we may have to develop non-infringing technology, enter into royalty or licensing agreements, adjust our merchandising or marketing activities or take other actions to resolve the claims. These actions, if required, may be costly or unavailable on terms acceptable to us.
We are engaged in legal proceedings that could cause us to incur unforeseen expenses and could occupy a significant amount of our management's time and attention.

From time to time, we are subject to litigation or claims that could negatively affect our business operations and financial position. As we have grown, we have seen a rise in the number of litigation matters against us.
Most of these matters relate to patent infringement lawsuits, which are typically expensive to defend. Litigation disputes could cause us to incur unforeseen expenses, could occupy a significant amount of our management's time and attention and could negatively affect our business operations and financial position.

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We could be subject to economic, political, regulatory and other risks arising from our international operations.
Operating in international markets requires significant resources and management attention and will subject us to regulatory, economic and political risks that may be different from and incremental to those in the U.S. In addition to the risks that we face in the U.S., our international operations involve risks that could adversely affect our business, including:

- the need to adapt our content and user interfaces for specific cultural and language differences, including licensing a certain portion of our content library before we have developed a full appreciation for its performance within a given territory;
- difficulties and costs associated with staffing and managing foreign operations;
- management distraction;
- political or social unrest and economic instability;
- compliance with U.S. laws such as the Foreign Corrupt Practices Act, export controls and economic sanctions, and local laws prohibiting corrupt payments to government officials;
- difficulties in understanding and complying with local laws, regulations and customs in foreign jurisdictions;
- unexpected changes in regulatory requirements;
- less favorable foreign intellectual property laws;
- adverse tax consequences such as those related to repatriation of cash from foreign jurisdictions into the United States, non-income related taxes such as value-added tax or other indirect taxes, such as ISS, PIS, COFINS and CIDE in Brazil, changes in tax laws or their interpretations, or the application of judgment in determining our global provision for income taxes and other tax liabilities given inter-company transactions and calculations where the ultimate tax determination is uncertain;
- fluctuations in currency exchange rates, which could impact revenues and expenses of our international operations and expose us to foreign currency exchange rate risk;
- profit repatriation and other restrictions on the transfer of funds;
- differing payment processing systems as well as consumer use and acceptance of electronic payment methods, such as payment cards;
- new and different sources of competition;
- low usage and/or penetration of Internet connected consumer electronic devices;
- different and more stringent user protection, data protection, privacy and other laws; and
- availability of reliable broadband connectivity and wide area networks in targeted areas for expansion;
- integration and operational challenges as well as potential unknown liabilities in connection with companies we may acquire or control; and
- differing, and often more lenient, laws and consumer understanding/attitudes regarding the illegality of piracy.

Our failure to manage any of these risks successfully could harm our international operations and our overall business, and results of our operations.

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 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.

We have debt outstanding and may incur additional debt in the future, which may adversely affect our financial condition and future financial results.

As of December 31, 2014, we had $500 million in 5.375% senior notes and $400 million in 5.75% senior notes. Risks relating to our long-term indebtedness include:

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- requiring us to dedicate a portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of cash flow to fund working capital, capital expenditures, acquisitions and investments and other general corporate purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business and the markets in which we operate; and
- limiting our ability to borrow additional funds or to borrow funds at rates or on other terms we find acceptable.

We intend to raise at least $1 billion, pending market conditions, of additional long-term debt in the first quarter of 2015 and it is possible that we may incur additional indebtedness in the future in the ordinary course of business. If new debt is added to current debt levels, the risks described above could intensify.

We may lose key employees or may be unable to hire qualified employees.

We rely on the continued service of our senior management, including our Chief Executive Officer and co-founder Reed Hastings, members of our executive team and other key employees and the hiring of new qualified employees. In our industry, there is substantial and continuous competition for highly-skilled business, product development, technical and other personnel. We may not be successful in recruiting new personnel and in retaining and motivating existing personnel, which may be disruptive to our operations.

If memberships to our Domestic DVD segment decline faster than anticipated, our business could be adversely affected.

The number of memberships to our DVD-by-mail offering is declining, and we anticipate that this decline will continue. We believe, however, that the domestic DVD business will continue to generate significant contribution profit for our business. The contribution profit generated by our domestic DVD business will help provide capital resources to fund our growth internationally. To the extent that the rate of decline in our DVD-by-mail business is greater than we anticipate, our business could be adversely affected. We do not anticipate increasing resources to our DVD operations and the technology used in its operations will not be meaningfully improved. To the extent that we experience service interruptions or other degradations in our DVD-by-mail service, members' satisfaction could be negatively impacted and we could experience an increase in DVD-by-mail member cancellations, which could adversely impact our business.

Changes in U.S. Postal rates or operations could adversely impact our operating results and member satisfaction.

We rely exclusively on the U.S. Postal Service to deliver DVDs from our shipping centers and to return DVDs to us from our members. Increases in postage delivery rates, including those resulting from changes to policies on the requirements of first class mail such as size, weight or machinability, could adversely affect our Domestic DVD segment's contribution profit. If the U.S. Postal Service were to implement other changes to improve its financial position, such as closing mail processing facilities or service reductions, such changes could lead to a decrease in customer satisfaction and our Domestic DVD segment's contribution profit could be adversely affected.

Risks Related to Our Stock Ownership

Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable.

Our charter documents may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable because they:

- authorize our board of directors, without stockholder approval, to issue up to 10,000,000 shares of undesignated preferred stock;
- provide for a classified board of directors;
- prohibit our stockholders from acting by written consent;
- establish advance notice requirements for proposing matters to be approved by stockholders at stockholder meetings; and
- prohibit stockholders from calling a special meeting of stockholders.

As a Delaware corporation, we are also subject to certain Delaware anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has

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held the stock for three years or, among other things, the board of directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

In addition, a merger or acquisition may trigger retention payments to certain executive employees under the terms of our Amended and Restated Executive Severance and Retention Incentive Plan, thereby increasing the cost of such a transaction.

Our stock price is volatile.

The price at which our common stock has traded has fluctuated significantly. The price may continue to be volatile due to a number of factors including the following, some of which are beyond our control:

- variations in our operating results;
- variations between our actual operating results and the expectations of securities analysts, investors and the financial community;
- announcements of developments affecting our business, systems or expansion plans by us or others;
- competition, including the introduction of new competitors, their pricing strategies and services;
- market volatility in general;
- the level of demand for our stock, including the amount of short interest in our stock; and
- the operating results of our competitors.

As a result of these and other factors, investors in our common stock may not be able to resell their shares at or above their original purchase price.

Following certain periods of volatility in the market price of our securities, we became the subject of securities litigation. We may experience more such litigation following future periods of volatility. This type of litigation may result in substantial costs and a diversion of management’s attention and resources.

Financial forecasting may differ materially from actual results.

Given the dynamic nature of our business, and the inherent limitations in predicting the future, forecasts of our revenues, contribution margins, net income and number of total and paid member additions and other financial and operating data may differ materially from actual results. Such discrepancies could cause a decline in the trading price of our common stock.

Item 1B. Unresolved Staff Comments

None.

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## Item 2. Properties

Our global streaming headquarters are located in Los Gatos, California and consist of leased space aggregating approximately 250,000 square feet. In the third quarter of 2013, the Company entered into lease agreements to expand its Los Gatos, California headquarters by 263,000 square feet with 124 month lease terms commencing after construction of the facilities, which is expected in 2015.

In the United States, we lease other offices in various locations, including Beverly Hills, California for global content acquisition, marketing and general and administrative operations and Fremont, California for our DVD operations. We also lease office space in other countries to support international streaming operations.

We believe that our existing facilities are adequate to meet current requirements, and that suitable additional or substitute space will be available as needed to accommodate any further physical expansion of operations and for any additional offices.

## Item 3. Legal Proceedings

Information with respect to this item may be found in Note 6 of Item 8, Financial Statements and Supplementary Data, under the caption "Legal Proceedings" which information is incorporated herein by reference.

## Item 4. Mine Safety Disclosures

Not applicable.

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PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

### Market Information

Our common stock is traded on the NASDAQ Global Select Market under the symbol "NFLX". The following table sets forth the intraday high and low sales prices per share of our common stock for the periods indicated, as reported by the NASDAQ Global Select Market.

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First quarter | $458.00 | $319.07 | $197.62 | $90.69 |
| Second quarter | 450.82 | 299.50 | 248.85 | 159.00 |
| Third quarter | 489.29 | 412.51 | 320.39 | 212.00 |
| Fourth quarter | 467.99 | 315.54 | 389.16 | 282.80 |

### Holders

As of January 28, 2015, there were approximately 203 stockholders of record of our common stock, although there is a significantly larger number of beneficial owners of our common stock.

### Dividends

We have not declared or paid any cash dividends, and we have no present intention of paying any cash dividends in the foreseeable future.

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Stock Performance Graph

Notwithstanding any statement to the contrary in any of our previous or future filings with the Securities and Exchange Commission, the following information relating to the price performance of our common stock shall not be deemed "filed" with the Commission or "soliciting material" under the Securities Exchange Act of 1934 and shall not be incorporated by reference into any such filings.

The following graph compares, for the five year period ended December 31, 2014, the total cumulative stockholder return on the Company's common stock with the total cumulative return of the NASDAQ Composite Index, the S&P 500 Index and the S&P North American Technology Internet Index. The Company was added to the S&P 500 Index on December 18, 2010. Measurement points are the last trading day of each of the Company's fiscal years ended December 31, 2009, December 31, 2010, December 31, 2011, December 31, 2012, December 31, 2013 and December 31, 2014. Total cumulative stockholder return assumes $100 invested at the beginning of the period in the Company's common stock, the stocks represented in the NASDAQ Composite Index, the stocks represented in the S&P 500 Index and the stocks represented in the S&P North American Technology Internet Index, respectively, and reinvestment of any dividends. The S&P North American Technology Internet Index is a modified-capitalization weighted index of stocks representing the Internet industry, including Internet content and access providers, Internet software and services companies and e-commerce companies. Historical stock price performance should not be relied upon as an indication of future stock price performance.

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Item 6. Selected Financial Data

The following selected consolidated financial data is not necessarily indicative of results of future operations and should be read in conjunction with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Financial Statements and Supplementary Data.

Consolidated Statements of Operations:

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (in thousands, except per share data) | | | | |
| Revenues | $5,504,656 | $4,374,562 | $3,609,282 | $3,204,577 | $2,162,625 |
| Operating income | 402,648 | 228,347 | 49,992 | 376,068 | 283,641 |
| Net income | 266,799 | 112,403 | 17,152 | 226,126 | 160,853 |
| Earnings per share: | | | | | |
| Basic | $4.44 | $1.93 | $0.31 | $4.28 | $3.06 |
| Diluted | $4.32 | $1.85 | $0.29 | $4.16 | $2.96 |
| Weighted-average common shares outstanding: | | | | | |
| Basic | 60,078 | 58,198 | 55,521 | 52,847 | 52,529 |
| Diluted | 61,699 | 60,761 | 58,904 | 54,369 | 54,304 |

Consolidated Statements of Cash Flows:

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (in thousands) | | | | |
| Net cash provided by operating activities | $16,483 | $97,831 | $21,586 | $317,712 | $276,401 |
| Free cash flow (1) | (126,699) | (16,300) | (58,151) | 186,550 | 131,007 |

(1) See "Liquidity and Capital Resources" for a definition of "free cash flow" and a reconciliation of "free cash flow" to "net cash provided by operating activities."

Consolidated Balance Sheets:

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (in thousands) | | | | |
| Cash, cash equivalents and short-term investments | $1,608,496 | $1,200,405 | $748,078 | $797,811 | $350,387 |
| Total content library, net | 4,899,028 | 3,797,492 | 2,874,170 | 1,966,643 | 361,979 |
| Working capital | 1,277,315 | 904,560 | 564,865 | 605,802 | 248,652 |
| Total assets | 7,056,651 | 5,412,563 | 3,967,890 | 3,069,196 | 982,067 |
| Long-term debt | 900,000 | 500,000 | 200,000 | 200,000 | 200,000 |
| Long-term debt due to related party | — | — | 200,000 | 200,000 | — |
| Non-current content liabilities | 1,575,832 | 1,345,590 | 1,076,622 | 739,628 | 48,179 |
| Total stockholders' equity | 1,857,708 | 1,333,561 | 744,673 | 642,810 | 290,164 |

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Other Data:

| | As of / Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (in thousands) | | | | |
| Net global streaming member additions during period (1) | 13,041 | 11,083 | 9,738 | — | — |
| Total global streaming members (1) | 57,391 | 44,350 | 33,267 | 23,529 | — |

Prior to certain changes to our pricing and plan structure in 2011, we did not separately track streaming memberships.

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

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview and Results of Operations

The following represents our consolidated performance highlights:

| | As of/ Year Ended December 31, | | | Change | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2014 vs. 2013 | 2013 vs. 2012 |
| | (in thousands) | | | | |
| Revenues | $5,504,656 | $4,374,562 | $3,609,282 | 26 % | 21 % |
| Operating income | $402,648 | $228,347 | $49,992 | 76 % | 357 % |
| Net income | $266,799 | $112,403 | $17,152 | 137 % | 555 % |
| Global streaming members | 57,391 | 44,350 | 33,267 | 29 % | 33 % |

Consolidated revenues for 2014 and 2013 increased as compared to prior years due to growth in both international and domestic streaming memberships, as well as increases in average revenue per paying member resulting from the introduction of higher priced plans. The increases in operating income and net income in each of the two years ended December 31, 2014 and 2013 were due to the increase in revenues, partially offset by the increase in the cost of revenues due to increased content expenses relating to our existing and new streaming content.

We offer three types of streaming membership plans. In the U.S. our basic plan is priced at $7.99 per month and includes access to standard definition quality streaming on a single screen at a time. Our most popular streaming plan, which includes access to high definition quality streaming on two screens concurrently, is priced at $8.99 per month for members who joined after the second quarter of 2014 when we had increased the membership fee from $7.99 per month. Existing members were grandfathered in at $7.99 for two years, as long as they remain a member. Our premium plan, which we introduced in the second quarter of 2013, is priced at $11.99 per month and includes access to high definition and ultra-high definition quality content on four screens concurrently. Internationally, pricing for the three types of membership plans is structured similar to the U.S. and ranges from the U.S. dollar equivalent of approximately $6.00 per month to $19.00.

The following represents the key elements to our segment results of operations:

- We define contribution profit as revenues less cost of revenues and marketing expenses. We believe this is an important measure of our operating segment performance as it represents each segment's performance before discrete global corporate costs.

- For the Domestic and International streaming segments, content expenses, which include the amortization of the streaming content library and other expenses associated with the licensing and acquisition of streaming content, represent the vast majority of cost of revenues. Streaming content rights are generally specific to a geographic region and accordingly our international expansion will require us to obtain additional streaming content to support new international markets. Other cost of revenues such as streaming delivery expenses, customer service and payment processing fees tend to be lower as a percentage of total cost of revenues as compared to content expenses. We utilize both our own and third-party content delivery networks to help us efficiently stream a high volume of content to our members over the Internet. Streaming delivery expenses, therefore, also include equipment costs related to our content delivery network ("Open Connect") and all third-party costs associated with delivering streaming content over the Internet. Cost of revenues in the Domestic DVD segment consist primarily of delivery expenses, content expenses, including amortization of DVD content library and revenue sharing expenses, and other expenses associated with our DVD processing and customer service centers. Delivery expenses for the Domestic DVD segment consist of the postage costs to mail DVDs to and from our members and the packaging and label costs for the mailers.

- For the Domestic and International streaming segments, marketing expenses consist primarily of advertising expenses and payments made to our affiliates and device partners. Advertising expenses include promotional activities such as television and online advertising. Payments to our affiliates and device partners include fixed fee and /or revenue sharing payments. Marketing expenses are primarily incurred by our Domestic and International streaming segments given our focus on building consumer awareness of the streaming offerings. Marketing expenses incurred by our International streaming segment have been significant and will fluctuate dependent upon the number of international territories in

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which our streaming service is offered and the timing of the launch of new territories. Marketing expenses are immaterial for the Domestic DVD segment.

- We have demonstrated our ability to grow domestic streaming contribution margin as evidenced by the increase in contribution margin from 17% in 2012 to 27% in 2014. As a result of our focus on growing the streaming segments, contribution margins for the Domestic and International streaming segments are lower than for our Domestic DVD segment. Investments in content and marketing associated with the International streaming segment will continue to fluctuate dependent upon the number of international territories in which our streaming service is offered and the timing of the launch of new territories.

Segment Results

Domestic Streaming Segment

Year ended December 31, 2014 as compared to the year ended December 31, 2013

| | As of/ Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 vs. 2013 | |
| | (in thousands, except revenue per member and percentages) | | | |
| Members: | | | | |
| Net additions | 5,694 | 6,274 | (580) | (9)% |
| Members at end of period | 39,114 | 33,420 | 5,694 | 17% |
| Paid members at end of period | 37,698 | 31,712 | 5,986 | 19% |
| Average monthly revenue per member | $8.14 | $7.97 | $0.17 | 2% |
| | | | | |
| Contribution profit: | | | | |
| Revenues | $3,431,434 | $2,751,375 | $680,059 | 25% |
| Cost of revenues | 2,201,761 | 1,863,376 | 338,385 | 18% |
| Marketing | 293,453 | 265,232 | 28,221 | 11% |
| Contribution profit | 936,220 | 622,767 | 313,453 | 50% |
| Contribution margin | 27% | 23% | | |

In the Domestic streaming segment, we derive revenues from monthly membership fees for services consisting solely of streaming content offered through a membership plan. The increase in our domestic streaming revenues was due to the 22% growth in the average number of paid memberships, as well as to the 2% increase in average monthly revenue per paying member resulting from our price increase for new members in the second quarter of 2014 and introduction of the higher priced plan in 2013. Our two screen high definition plan continues to be the most popular plan choice for new members.

The increase in domestic streaming cost of revenues was primarily due to the $242.3 million increase in content expenses relating to our existing and new streaming content, including more exclusive and original programming. In addition, streaming delivery expenses increased by $59.5 million and other costs, such as payment processing fees and customer service call centers, increased $36.6 million due to our growing member base.

Marketing expenses increased primarily due to an increase in advertising and public relations spending.

Our Domestic streaming segment had a contribution margin of 27% for the year ended December 31, 2014, which increased as compared to the contribution margin of 23% for the year ended December 31, 2013 due to growth in paid memberships and revenue, which continued to outpace content and marketing spending. The decrease in net membership additions in the year ended December 31, 2014 as compared to the year ended December 31, 2013 is a natural progression of our large domestic market as we grow. We expect to continue to increase domestic contribution margins over the next several years even with lower membership growth.

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Year ended December 31, 2013 as compared to the year ended December 31, 2012

| | As of/ Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 vs. 2012 | |
| | (in thousands, except revenue per member and percentages) | | | |
| Members: | | | | |
| Net additions | 6,274 | 5,475 | 799 | 15 % |
| Members at end of period | 33,420 | 27,146 | 6,274 | 23 % |
| Paid members at end of period | 31,712 | 25,471 | 6,241 | 25 % |
| Average monthly revenue per member | $7.97 | $7.97 | $— | — % |
| Contribution profit: | | | | |
| Revenues | $2,751,375 | $2,184,868 | $566,507 | 26 % |
| Cost of revenues | 1,863,376 | 1,570,600 | 292,776 | 19 % |
| Marketing | 265,232 | 245,259 | 19,973 | 8 % |
| Contribution profit | 622,767 | 369,009 | 253,758 | 69 % |
| Contribution margin | 23 % | 17 % | | |

The increase in our domestic streaming revenues was due to the 26% growth in the average number of paid memberships. New member additions and revenue related to $11.99 membership plans that were introduced in the second quarter of 2013 were not material for the year ended December 31, 2013.

The increase in domestic streaming cost of revenues was primarily due to the $226.3 million increase in content expenses resulting from continued investments in existing and new streaming content including more exclusive and original programming. In addition, streaming delivery expenses increased by $31.7 million and other costs, such as payment processing fees and customer service call centers, increased $34.8 million due to our growing member base.

Marketing expenses increased primarily due to an increase in advertising partially offset by a decrease in payments to affiliates in the U.S.

Our Domestic streaming segment had a contribution margin of 23% for the year ended December 31, 2013, which increased as compared to the contribution margin of 17% for the year ended December 31, 2012, as a result of growing memberships and revenue faster than content and marketing spending.

International Streaming Segment

Year ended December 31, 2014 as compared to the year ended December 31, 2013

| | As of/ Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 vs. 2013 | |
| | (in thousands, except revenue per member and percentages) | | | |
| Members: | | | | |
| Net additions | 7,347 | 4,809 | 2,538 | 53 % |
| Members at end of period | 18,277 | 10,930 | 7,347 | 67 % |
| Paid members at end of period | 16,778 | 9,722 | 7,056 | 73 % |
| Average monthly revenue per member | $8.34 | $8.26 | $0.08 | 1 % |
| Contribution loss: | | | | |
| Revenues | $1,308,061 | $712,390 | $595,671 | 84 % |
| Cost of revenues | 1,154,117 | 782,304 | 371,813 | 48 % |
| Marketing | 313,733 | 204,418 | 109,315 | 53 % |
| Contribution loss | (159,789 ) | (274,332 ) | 114,543 | (42 )% |

| | | |
|---|---|---|
| Contribution margin | (12 )% | (39 )% |

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In the International streaming segment, we derive revenues from monthly membership fees for services consisting solely of streaming content offered through a membership plan. We launched our streaming service in Canada in September 2010 and have continuously expanded our services internationally with launches in Latin America in September 2011, the U.K. and Ireland in January 2012, Finland, Denmark, Sweden and Norway in October 2012, the Netherlands in September 2013, and Germany, Austria, Switzerland, France, Belgium and Luxembourg in September 2014. In the first quarter of 2015, we expect to launch our service in Australia and New Zealand. Later in the year, we expect to launch additional major countries, in keeping with our global strategy.

The increase in our international revenues was primarily due to the 82% growth in the average number of paid international memberships as well as the 1% increase in average monthly revenue per paying member resulting from the price increase on our most popular streaming plan and the introduction of the premium plan, offset partially by the impact of exchange rate fluctuations. Average paid international streaming memberships account for 27% of total average paid streaming memberships as of December 31, 2014, as compared to 20% of total average paid streaming memberships as of December 31, 2013.

The increase in international cost of revenues was primarily due to a $311.5 million increase in content expenses including content for our new markets as well as more exclusive and original programming. Other costs increased $60.3 million primarily due to increases in our streaming delivery expenses, costs associated with our customer service call centers and payment processing fees, all driven by our growing member base.

International marketing expenses for the year ended December 31, 2014 increased as compared to the year ended December 31, 2013 mainly due to expenses for territories launched in the last twelve months.

International contribution losses improved $114.5 million year over year, as a result of growing memberships and revenues faster than content and marketing spending. Our International streaming segment does not benefit from the established member base that exists for the Domestic segments. As a result of having to build a member base from zero, investments in streaming content and marketing programs for our International segment are larger initially relative to revenues, in particular as new territories are launched. The contribution losses for our International segment have been significant due to investments in streaming content and marketing programs to drive membership growth and viewing in our international markets.

Year ended December 31, 2013 as compared to the year ended December 31, 2012

| | As of/ Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 vs. 2012 | |
| | (in thousands, except revenue per member and percentages) | | | |
| Members: | | | | |
| Net additions | 4,809 | 4,263 | 546 | 13 % |
| Members at end of period | 10,930 | 6,121 | 4,809 | 79 % |
| Paid members at end of period | 9,722 | 4,892 | 4,830 | 99 % |
| Average monthly revenue per member | $8.26 | $7.80 | $0.46 | 6 % |
| Contribution loss: | | | | |
| Revenues | $712,390 | $287,542 | $424,848 | 148 % |
| Cost of revenues | 782,304 | 483,295 | 299,009 | 62 % |
| Marketing | 204,418 | 193,390 | 11,028 | 6 % |
| Contribution loss | (274,332 ) | (389,143 ) | 114,811 | (30 )% |
| Contribution margin | (39 )% | (135 )% | | |

The increase in our international revenues was primarily due to the 134% growth in the average number of paid international memberships.

The increase in international cost of revenues was primarily due to a $272.0 million increase in content expenses. This increase was primarily attributable to continued investments in existing and new streaming content including content to support the launch of our service in the Nordics (launched in the fourth quarter of 2012) and the Netherlands (launched in the third quarter of 2013). Other costs increased $27.0 million due to increases in our streaming delivery expenses, costs associated with our customer service call centers and payment processing fees, all driven by our growing member base.

International marketing expenses for the year ended December 31, 2013 increased as compared to the year ended December 31, 2012 due to our expansion in the Nordics and the Netherlands offset partially by a decrease in spending in other territories.

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International contribution losses improved $114.8 million year over year, as a result of growing memberships and revenues faster than content and marketing spending.

Domestic DVD Segment

Year ended December 31, 2014 as compared to the year ended December 31, 2013

| | As of/ Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 vs. 2013 | |
| | (in thousands, except revenue per member and percentages) | | | |
| Members: | | | | |
| Net losses | (1,163) | (1,294) | (131) | (10)% |
| Members at end of period | 5,767 | 6,930 | (1,163) | (17)% |
| Paid members at end of period | 5,668 | 6,765 | (1,097) | (16)% |
| Average monthly revenue per member | $10.29 | $10.25 | $0.04 | — % |
| Contribution profit: | | | | |
| Revenues | $765,161 | $910,797 | $(145,636) | (16)% |
| Cost of revenues | 396,882 | 471,523 | (74,641) | (16)% |
| Marketing | — | 292 | (292) | (100)% |
| Contribution profit | 368,279 | 438,982 | (70,703) | (16)% |
| Contribution margin | 48% | 48% | | |

In the Domestic DVD segment, we derive revenues from our DVD-by-mail membership services. The price per plan for DVD-by-mail varies from $4.99 to $43.99 per month according to the plan chosen by the member. DVD-by-mail plans differ by the number of DVDs that a member may have out at any given point. Members electing access to high definition Blu-ray discs, in addition to standard definition DVDs, pay a surcharge ranging from $2 to $4 per month for our most popular plans.

The decrease in our domestic DVD revenues was due to a 16% decrease in the average number of paid memberships. The decrease in domestic DVD cost of revenues was primarily due to a $16.0 million decrease in content expenses and a $43.0 million decrease in delivery expenses resulting from a 22% decrease in the number of DVDs mailed to members. The decrease in shipments was driven by a decline in the number of DVD memberships coupled with a decrease in usage by these members. Other costs, primarily those associated with processing and customer service expenses, decreased $15.6 million primarily due to a decrease in hub operation expenses resulting from the decline in DVD shipments.

Our Domestic DVD segment had a contribution margin of 48% for the year ended December 31, 2014, and was flat as compared to the year ended December 31, 2013.

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Year ended December 31, 2013 as compared to the year ended December 31, 2012

| | As of/ Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 vs. 2012 | |
| | (in thousands, except revenue per member and percentages) | | | |
| Members: | | | | |
| Net losses | (1,294) | (2,941) | (1,647) | (56)% |
| Members at end of period | 6,930 | 8,224 | (1,294) | (16)% |
| Paid members at end of period | 6,765 | 8,049 | (1,284) | (16)% |
| Average monthly revenue per member | $10.25 | $10.21 | $0.04 | — % |
| Contribution profit: | | | | |
| Revenues | $910,797 | $1,136,872 | $(226,075) | (20)% |
| Cost of revenues | 471,523 | 598,163 | (126,640) | (21)% |
| Marketing | 292 | 559 | (267) | (48)% |
| Contribution profit | 438,982 | 538,150 | (99,168) | (18)% |
| Contribution margin | 48 % | 47 % | | |

The decrease in our domestic DVD revenues was due to a 20% decrease in the average number of paid memberships. The decrease in domestic DVD cost of revenues was primarily due to a $62.0 million decrease in content expenses and a $44.2 million decrease in delivery expenses resulting from a 19% decrease in the number of DVDs mailed to members. The decrease in shipments was driven by a decline in the number of DVD memberships. Other costs, primarily those associated with content processing and customer service center expenses, decreased $20.4 million primarily due to a decrease in hub operation expenses resulting from the decline in DVD shipments.
Our Domestic DVD segment had a contribution margin of 48% for the year ended December 31, 2013, and was relatively flat as compared to the year ended December 31, 2012.

Consolidated Operating Expenses
Technology and Development
Technology and development expenses consist of payroll and related costs incurred in making improvements to our service offerings, including testing, maintaining and modifying our user interface, our recommendation, merchandising and streaming delivery technology, as well as our telecommunications systems and infrastructures. Technology and development expenses also include costs associated with computer hardware and software.

| | Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 vs. 2013 | |
| | (in thousands, except percentages) | | | |
| Technology and development | $472,321 | $378,769 | $93,552 | 25 % |
| As a percentage of revenues | 9 % | 9 % | | |

The increase in technology and development expenses was primarily due to an $87.4 million increase in personnel-related costs, including stock-based compensation expense, resulting from an increase in compensation for existing employees and a 12% growth in average headcount supporting continued improvements in our streaming service and our international expansion.

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| | Year Ended December 31, 2013 | 2012 | Change 2013 vs. 2012 | |
|---|---|---|---|---|
| | (in thousands, except percentages) | | | |
| Technology and development | $378,769 | $329,008 | $49,761 | 15 % |
| As a percentage of revenues | 9 % | 9 % | | |

The increase in technology and development expenses was primarily the result of a $42.8 million increase in personnel-related costs. These increases are primarily due to increases in employee compensation as well as an 8% growth in average headcount supporting continued improvements in our streaming service and international expansion.

General and Administrative

General and administrative expenses consist of payroll and related expenses for corporate personnel, as well as professional fees and other general corporate expenses. General and administrative expenses also include the gain on disposal of DVDs.

| | Year Ended December 31, 2014 | 2013 | Change 2014 vs. 2013 | |
|---|---|---|---|---|
| | (in thousands, except percentages) | | | |
| General and administrative | $269,741 | $180,301 | $89,440 | 50 % |
| As a percentage of revenues | 5 % | 4 % | | |

General and administrative expenses increased primarily due to a $70.6 million increase in personnel-related costs, including stock-based compensation expense, resulting from a 37% increase in average headcount primarily to support our international expansion, and an increase in compensation for existing employees. In addition, there was an $11.6 million increase in legal costs for the year ended December 31, 2014 as compared to the year ended December 31, 2013.

| | Year Ended December 31, 2013 | 2012 | Change 2013 vs. 2012 | |
|---|---|---|---|---|
| | (in thousands, except percentages) | | | |
| General and administrative | $180,301 | $139,016 | $41,285 | 30 % |
| As a percentage of revenues | 4 % | 4 % | | |

The increase in general and administrative expenses was primarily due to a $22.0 million increase in personnel-related costs resulting from a 31% increase in average headcount to support our growth. In addition, expenses related to the use of outside and professional services, taxes and insurance increased $8.9 million. The increase in expenses was further impacted by an $8.0 million decrease in the gain on the disposal of DVDs.

Interest Expense

Interest expense consists primarily of the interest associated with our outstanding long-term debt obligations, including the amortization of debt issuance costs, as well as interest on our lease financing obligations.

| | Year Ended December 31, 2014 | 2013 | Change 2014 vs. 2013 | |
|---|---|---|---|---|
| | (in thousands, except percentages) | | | |
| Interest expense | $(50,219) | $(29,142) | $(21,077) | (72)% |
| As a percentage of revenues | 1 % | 1 % | | |

Interest expense for the year ended December 31, 2014 consists primarily of $46.8 million of interest on our notes. The increase in interest expense for the year ended December 31, 2014 as compared to the year ended December 31, 2013 is due to the higher aggregate principal of interest bearing notes outstanding.

| | Year Ended December 31, 2013 | 2012 | Change 2013 vs. 2012 | |
|---|---|---|---|---|
| | (in thousands, except percentages) | | | |
| Interest expense | $(29,142) | $(19,986) | $(9,156) | (46)% |
| As a percentage of revenues | 1 % | 1 % | | |

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Interest expense for the year ended December 31, 2013 consists primarily of $26.1 million of interest on our 5.375% Notes. The increase in interest expense for the year ended December 31, 2013 as compared to the year ended December 31, 2012 is due to the higher aggregate principal of interest bearing notes outstanding, partially offset by their lower interest rate.

Interest and Other Income (Expense)

Interest and other income (expense) consists primarily of interest earned on cash, cash equivalents and short-term investments and foreign exchange gains and losses on foreign currency denominated balances.

| | Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 vs. 2013 | |
| | (in thousands, except percentages) | | | |
| Interest and other income (expense) | $(3,060) | $(3,002) | $(58) | (2)% |

Interest and other income (expense) was relatively flat as compared to the prior year. Losses on foreign currency denominated balances were $8.2 million and $8.4 million for the years ended December 31, 2014 and 2013, respectively.

| | Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 vs. 2012 | |
| | (in thousands, except percentages) | | | |
| Interest and other income (expense) | $(3,002) | $474 | $(3,476) | (733)% |

Interest and other income (expense) decreased due to increased foreign exchange losses on foreign currency denominated balances. The foreign exchange losses were $8.4 million and $4.0 million for the years ended December 31, 2013 and 2012, respectively.

Extinguishment of Debt

In connection with the redemption of the outstanding $200.0 million aggregate principal amount of the 8.50% Notes, we recognized a loss on extinguishment of debt of $25.1 million in the year ended December 31, 2013, which consisted of expenses associated with the redemption, including a $19.4 million premium payment pursuant to the make-whole provision in the indenture governing the 8.50% Notes. For further detail see Note 5 of Item 8, Financial Statements and Supplementary Data.

Provision for Income Taxes

| | Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 vs. 2013 | |
| | (in thousands, except percentages) | | | |
| Provision for income taxes | $82,570 | $58,671 | $23,899 | 41% |
| Effective tax rate | 24% | 34% | | |

In 2014, the difference between our 24% effective tax rate and the federal statutory rate of 35% was $39.7 million primarily due to the release of tax reserves on previously unrecognized tax benefits of $38.6 million as a result of an IRS Appeals settlement for the tax years 2008-2009 leading to the reassessment of our reserves for all open years, coupled with the retroactive reinstatement of the 2014 Federal research and development ("R&D") credits partially offset by state income taxes, foreign taxes and nondeductible expenses. The decrease in our effective tax rate for the year ended December 31, 2014 as compared to the year ended December 31, 2013 was primarily attributable to the $38.6 million release of tax reserves on previously unrecognized tax benefits.

On December 19, 2014, the Tax Increase Prevention Act of 2014 (H.R. 5771) was signed into law which retroactively extended the Federal R&D credit from January 1, 2014 through December 31, 2014. As a result, we recognized the retroactive benefit of the 2014 Federal R&D credit of approximately $10.7 million as a discrete item in the fourth quarter of 2014, the period in which the legislation was enacted.

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| | Year Ended December 31, | | Change | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 vs. 2012 | |
| | (in thousands, except percentages) | | | |
| Provision for income taxes | $58,671 | $13,328 | $45,343 | 340 % |
| Effective tax rate | 34 % | 44 % | | |

In 2013, the difference between our effective tax rate and the federal statutory rate of 35% was $1.2 million primarily due to the Federal and California R&D credits partially offset by state income taxes and nondeductible expenses. The decrease in our effective tax rate for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was primarily attributable to the retroactive reinstatement of the 2012 Federal R&D credit in January 2013.

On January 2, 2013, the American Taxpayer Relief Act of 2012 (H.R. 8) was signed into law which retroactively extended the Federal R&D credit from January 1, 2012 through December 31, 2013. As a result, we recognized the retroactive benefit of the 2012 Federal R&D credit of approximately $3.1 million as a discrete item in the first quarter of 2013, the period in which the legislation was enacted.

## Liquidity and Capital Resources

Cash, cash equivalents and short-term investments were $1,608.5 million and $1,200.4 million as of December 31, 2014 and 2013, respectively. In February 2014, we issued $400.0 million aggregate principal amount of 5.750% Senior Notes due 2024 (the "5.750% Notes"). In February 2013, we issued $500.0 million aggregate principal amount of 5.375% Senior Notes due 2021 (the "5.375% Notes"). We used approximately $224.5 million of the net proceeds of our 5.375% Notes to redeem our outstanding 8.50% Notes, including a $19.4 million make-whole premium and $5.1 million of accrued and unpaid interest. In November 2011, we issued $200.0 million of Senior Convertible Notes. The Senior Convertible Notes consisted of $200.0 million aggregate principal amount due on December 1, 2018 and did not bear interest. In April 2013, we exercised our option to cause the conversion of the Convertible Notes into shares of our common stock. See Note 5 of Item 8, Financial Statements and Supplementary Data for additional information.

Our primary uses of cash include content acquisition and licensing, streaming delivery, marketing programs and payroll. Payment terms for certain content agreements require more upfront cash payments relative to the expense and therefore, future investments could impact our liquidity.

We expect to significantly increase our investments in international expansion and in streaming content, particularly in original content. As a result, and to take advantage of the current favorable interest rate environment, we plan to obtain at least $1 billion in long-term debt in the first quarter of 2015. Our ability to obtain this, or any additional financing that we may choose to or need to obtain, 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. We may not be able to obtain such financing on terms acceptable to us or at all. If we raise additional funds through the issuance of equity 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.

As of December 31, 2014, $130.8 million of cash and cash equivalents were held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. income taxes and foreign withholding taxes on the amount associated with undistributed earnings for certain foreign subsidiaries. As of December 31, 2014, the amount associated with undistributed earnings for certain foreign subsidiaries for which we could be required to accrue and pay taxes is $29.2 million. See Note 10 of Item 8, Financial Statements and Supplementary Data for additional information.

### Free Cash Flow

We define free cash flow as cash provided by operating and investing activities excluding the non-operational cash flows from purchases, maturities and sales of short-term investments. We believe free cash flow is an important liquidity metric because it measures, during a given period, the amount of cash generated that is available to repay debt obligations, make investments and for certain other activities. Free cash flow is considered a non-GAAP financial measure and should not be considered in isolation of, or as a substitute for, net income, operating income, cash flow provided by operating activities, or any other measure of financial performance or liquidity presented in accordance with GAAP.

In assessing liquidity in relation to our results of operations, we compare free cash flow to net income, noting that the three major recurring differences are excess content payments over expense, non-cash stock-based compensation expense and other working capital differences. The excess content payments over expense is variable based on the payment terms of our

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content agreements and is expected to continue to be significant as we enter into more agreements with upfront cash payments, such as original content agreements. Working capital differences include deferred revenue, taxes and semi-annual interest payments on our outstanding debt. Our receivables from members generally settle quickly and deferred revenue is a source of cash flow.

| | Year Ended December 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| Net cash provided by operating activities | $16,483 | $97,831 |
| Net cash used in investing activities | (42,866) | (255,968) |
| Net cash provided by financing activities | 541,712 | 476,264 |
| | | |
| Non-GAAP free cash flow reconciliation: | | |
| Net cash provided by operating activities | 16,483 | 97,831 |
| Acquisition of DVD content library | (74,790) | (65,927) |
| Purchases of property and equipment | (69,726) | (54,143) |
| Other assets | 1,334 | 5,939 |
| Non-GAAP free cash flow | $(126,699) | $(16,300) |

Cash provided by operating activities decreased $81.3 million, primarily due to increased payments for content other than DVD library of $835.1 million or 32%, as well as increased payments associated with higher operating expenses. The increased use of cash was partially offset by a $1,130.1 million or 26% increase in revenues.

Cash used in investing activities decreased $213.1 million, primarily due to a decrease of $242.2 million in the purchases of short-term investments, net of proceeds from sales and maturities. This decrease was offset by an increase of $15.6 million purchases of property and equipment.

Cash provided by financing activities increased $65.4 million primarily due to the $392.9 million net proceeds from the issuance of the 5.750% Notes in the year ended December 31, 2014 as compared to the $490.6 million net proceeds from the issuance of the 5.375% Notes less the $219.4 million redemption of our 8.50% Notes in the year ended December 31, 2013. This increase was partially offset by a decrease of $56.3 million from the issuance of common stock, including the impact of excess tax benefits.

Free cash flow was $393.5 million lower than net income for the year ended December 31, 2014 primarily due to $534.2 million of content cash payments over expense partially offset by $115.2 million of non-cash stock-based compensation expense and $25.5 million of favorable other working capital differences.

Free cash flow was $128.7 million lower than net income for the year ended December 31, 2013 primarily due to $227.9 million of content cash payments over expense and $45.3 million non-favorable other working capital differences. This was partially offset by $73.1 million non-cash stock-based compensation expense, $46.3 million in deferred revenue and $25.1 million loss on debt extinguishment, the cash impact of which is a financing activity and therefore not included in free cash flow.

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| | Year Ended December 31, | |
|---|---|---|
| | 2013 | 2012 |
| | (in thousands) | |
| Net cash provided by operating activities | $97,831 | $21,586 |
| Net cash used in investing activities | (255,968) | (244,740) |
| Net cash provided by financing activities | 476,264 | 5,589 |
| | | |
| Non-GAAP free cash flow reconciliation: | | |
| Net cash provided by operating activities | 97,831 | 21,586 |
| Acquisition of DVD content library | (65,927) | (48,275) |
| Purchases of property and equipment | (54,143) | (40,278) |
| Other assets | 5,939 | 8,816 |
| Non-GAAP free cash flow | $(16,300) | $(58,151) |

Cash provided by operating activities increased $76.2 million, primarily due to an increase in revenues of $765.3 million or 21%. This increase was partially offset by increased payments for content acquisition and licensing other than DVD library of $502.6 million or 24% as well as increased payments associated with higher operating expenses. Operating activities were further impacted by increased payments for streaming delivery, payment processing fees and customer service call centers due to our growing member base.

Cash used in investing activities increased $11.2 million, primarily due to an increase of $17.7 million in the acquisition of DVD content library and a $13.9 million increase in the purchase of property and equipment primarily due to investments in our streaming delivery network. Cash outflow was offset by a $23.2 million increase in the proceeds from sales and maturities of short-term investments, net of purchases.

Cash provided by financing activities increased $470.7 million. In the first quarter of 2013, we issued $500.0 million of 5.375% Notes, with net proceeds of $490.6 million after payment of debt issuance costs. This was offset by the $219.4 million redemption of our 8.50% Senior Notes. Financing activities were further impacted by $197.6 million of increased cash flows provided by stock option exercises.

Free cash flow was $75.3 million lower than net income for the year ended December 31, 2012 primarily due to $143.9 million of content cash payments over expense and $5.3 million non-favorable other working capital differences partially offset by $73.9 million non-cash stock-based compensation expense.

### Contractual Obligations

For the purpose of this table, contractual obligations for purchases of goods or services are defined as agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The expected timing of payment of the obligations discussed below is estimated based on information available to us as of December 31, 2014. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services or changes to agreed-upon amounts for some obligations. The following table summarizes our contractual obligations at December 31, 2014:

| | Payments due by Period | | | | |
|---|---|---|---|---|---|
| Contractual obligations (in thousands): | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Streaming content obligations (1) | $9,451,112 | $3,747,648 | $4,495,103 | $1,164,308 | $44,053 |
| Debt (2) | 1,290,948 | 49,875 | 99,750 | 99,750 | 1,041,573 |
| Lease obligations (3) | 211,133 | 35,501 | 64,775 | 34,727 | 76,130 |
| Other purchase obligations (4) | 496,916 | 220,393 | 269,584 | 6,654 | 285 |
| Total | $11,450,109 | $4,053,417 | $4,929,212 | $1,305,439 | $1,162,041 |

(1) As of December 31, 2014, streaming content obligations were comprised of $2.1 billion included in "Current content liabilities" and $1.6 billion of "Non-current content liabilities" on the Consolidated Balance Sheets and $5.8 billion of

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obligations that are not reflected on the Consolidated Balance Sheets as they do not yet meet the criteria for asset recognition.

Streaming content obligations increased $2.2 billion from $7.3 billion as of December 31, 2013 to $9.5 billion as of December 31, 2014 primarily due to multi-year commitments associated with our latest market launches in Europe and the continued expansion of our exclusive and original programming.

A streaming content obligation is incurred at the time we enter into an agreement to obtain future titles. Once a title becomes available, a content liability is generally recorded on the Consolidated Balance Sheets. Certain agreements include the obligation to license rights for unknown future titles, the ultimate quantity and / or fees for which are not yet determinable as of the reporting date. Because the amount is not reasonably estimable, we do not include any estimated obligation for these future titles beyond the known minimum amount. However, the unknown obligations are expected to be significant and the expected timing of payments could range from less than one year to more than five years. Traditional film output deals, like the future output deal with Disney, or certain TV series license agreements where the number of seasons to be aired is unknown, are examples of license agreements not included in the contractual obligations table. Once we know the title that we will receive and the license fees, we include the amount in the streaming content obligations.

(2) Long-term debt obligations include our 5.375% Notes and 5.750% Notes consisting of principal and interest payments. See Note 5 of Item 8, Financial Statements and Supplementary Data for further details.

(3) Lease obligations include lease financing obligations of $9.4 million related to our current Los Gatos, California headquarters for which we are the deemed owner for accounting purposes and commitments of $201.7 million for facilities under non-cancelable operating leases with various expiration dates through approximately 2025, including commitments of $122.2 million for facilities lease agreements which will commence after the leased buildings have been constructed.

(4) Other purchase obligations include all other non-cancelable contractual obligations. These contracts are primarily related to streaming delivery, DVD content acquisition, and miscellaneous open purchase orders for which we have not received the related services or goods.

As of December 31, 2014, we had gross unrecognized tax benefits of $34.8 million and an additional $0.4 million for gross interest and penalties classified as “Other non-current liabilities” on the Consolidated Balance Sheets. At this time, we are not able to make a reasonably reliable estimate of the timing of payments in individual years due to uncertainties in the timing of tax audit outcomes; therefore, such amounts are not included in the above contractual obligation table.

Off-Balance Sheet Arrangements

We do not have any transactions with unconsolidated entities, such as entities often referred to as structured finance or special purpose entities, whereby we have financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose us to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to us.

Indemnifications

The information set forth under Note 7 of Item 8, Financial Statements and Supplementary Data under the caption “Guarantees—Indemnification Obligations” is incorporated herein by reference.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported periods. The Securities and Exchange Commission (“SEC”) has defined a company’s critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and results of operations, and which require a company to make its most difficult and subjective judgments. Based on this definition, we have identified the critical accounting policies and judgments addressed below. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates.

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Streaming Content

We license and acquire rights to stream TV shows, movies, and original content to members for unlimited viewing. These rights are for a fixed fee and specify windows of availability. Payment terms for certain content agreements require more upfront cash payments relative to expense.
We capitalize the fee per title and record a corresponding liability at the gross amount of liabilities when the license period begins, the cost of the title is known and the title is accepted and available for streaming. The portion available for streaming within one year is recognized as "Current content library, net" and the remaining portion as "Non-current content library, net" on the Consolidated Balance sheets. The acquisition of streaming content rights and the changes in related liabilities are classified within cash provided by operating activities on the Consolidated Statements of Cash Flows.

We amortize the content library in "Cost of revenues" on a straight line or on an accelerated basis, as appropriate:

- For content that does not premiere on the Netflix service (representing the vast majority of content), we amortize on a straight-line basis over the shorter of each title's contractual window of availability or estimated period of use, beginning with the month of first availability. The amortization period typically ranges from six months to five years.
- For content that premieres on the Netflix service, we expect more upfront viewing due to the additional merchandising and marketing efforts for this original content available only on Netflix. Hence, we amortize on an accelerated basis over the amortization period, which is the shorter of four years or the license period, beginning with the month of first availability. If a subsequent season is added, the amortization period is extended by a year.
- If the cost per title cannot be reasonably estimated, the license fee is not capitalized and costs are expensed on a straight line basis over the license period. This typically occurs when the license agreement does not specify the number of titles, the license fee per title or the windows of availability per title.

We review factors impacting the amortization of the content library, including historical and estimated viewing patterns, on a regular basis. Our estimates related to these factors require considerable management judgment. Changes in our estimates could have a significant impact on our future results of operations.
The content library is stated at the lower of unamortized cost or net realizable value. Streaming content (whether capitalized or not) is reviewed in aggregate at the geographic region level for impairment when an event or change in circumstances indicates a change in the expected usefulness of the content. The level of geographic aggregation is determined based on the streaming content rights which are generally specific to a geographic region inclusive of several countries (such as Latin America). No material write down from unamortized cost to a lower net realizable value was recorded in any of the periods presented.
We have entered into certain licenses with performing rights organizations ("PROs"), and are currently involved in negotiations with other PROs, that hold certain rights to music and other entertainment works "publicly performed" in connection with streaming content into various territories. Accruals for estimated license fees are recorded and then adjusted based on any changes in estimates. These amounts are included in the streaming content obligations. The results of these negotiations are uncertain and may be materially different from management's estimates.
Income Taxes
We record a provision for income taxes for the anticipated tax consequences of our reported results of operations 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 as well as net 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.
Although we believe our assumptions, judgments and estimates are reasonable, changes in tax laws or our interpretation of tax laws and the resolution of any tax audits could significantly impact the amounts provided for

income taxes in our consolidated financial statements.

In evaluating our ability to recover our deferred tax assets, in full or in part, we consider all available positive and negative evidence, including our past operating results, and our forecast of future earnings, future taxable income and prudent and feasible tax planning strategies. The assumptions utilized in determining future taxable income require significant judgment and are consistent with the plans and estimates we are using to manage the underlying businesses. Actual operating results in future years could differ from our current assumptions, judgments and estimates. However, we believe that it is more

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likely than not that substantially all deferred tax assets recorded on our Consolidated Balance Sheets will ultimately be realized. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period in which we make such determination.

We did not recognize certain tax benefits from uncertain tax positions within the provision for income taxes. We may recognize a tax benefit only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. At December 31, 2014, our estimated gross unrecognized tax benefits were $34.8 million of which $29.2 million, if recognized, would favorably impact our future earnings. Due to uncertainties in any tax audit outcome, our estimates of the ultimate settlement of our unrecognized tax positions may change and the actual tax benefits may differ significantly from the estimates. See Note 10 of Item 8, Financial Statements and Supplementary Data for further information regarding income taxes.

Stock-Based Compensation

Stock-based compensation expense at the grant date is based on the total number of options granted and an estimate of 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 calculate the fair value of our stock option grants using a lattice-binomial model. This model requires the input of highly subjective assumptions. Changes in the subjective input assumptions can materially affect the estimate of fair value of options granted and our results of operations could be 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. Low trade volume of our tradable forward call options prior to 2011 precluded sole reliance on implied volatility, and as such we include historical volatility in our computation of expected volatility. An increase/decrease of 10% in our computation of expected volatility would increase/decrease the total stock-based compensation expense by approximately $10.9 million for the year ended December 31, 2014.
- Suboptimal Exercise Factor: Our computation of the suboptimal exercise factor is based on historical option exercise behavior and is determined for both executives and non-executives. An increase/decrease in the suboptimal exercise factor of 10% would increase/decrease the total stock-based compensation expense by approximately $2.4 million for the year ended December 31, 2014.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risks related to interest rate changes and the corresponding changes in the market values of our investments, debt and foreign currency fluctuations.

Interest Rate Risk

The primary objective of our investment activities is to preserve principal, while at the same time maximizing income we receive from investments without significantly increased risk. To achieve this objective, we follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes. We maintain a portfolio of cash equivalents and short-term investments in a variety of securities. These securities are classified as available-for-sale and are recorded at fair value with unrealized gains and losses, net of tax, included in “Accumulated other comprehensive (loss) income” within Stockholders' equity in the Consolidated Balance Sheets.

For the year ended December 31, 2014, we had no material impairment charges associated with our short-term investment portfolio. Although we believe our current investment portfolio has very little risk of material impairment, we cannot predict future market conditions or market liquidity and can provide no assurance that our investment portfolio will remain materially unimpaired. Some of the securities we invest in may be subject to market risk due to changes in prevailing interest rates which may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the value of our investment will decline. At December 31, 2014, our cash equivalents were generally invested in money market funds, which are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate. Our short-term investments were comprised of corporate debt securities, government and agency securities and asset backed securities.

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Changes in interest rates could adversely affect the market value of the securities we hold that are classified as short-term investments. The table below separates these investments, based on stated maturities, to show the approximate exposure to interest rates as of December 31, 2014.

| | (in thousands) |
|---|---|
| Due within one year | $113,864 |
| Due after one year and through 5 years | 381,024 |
| Total | $494,888 |

A sensitivity analysis was performed on our investment portfolio as of December 31, 2014. The analysis is based on an estimate of the hypothetical changes in market value of the portfolio that would result from an immediate parallel shift in the yield curve of various magnitudes. This methodology assumes a more immediate change in interest rates to reflect the current economic environment.

The following table presents the hypothetical fair values of our debt securities classified as short-term investments assuming immediate parallel shifts in the yield curve of 50 basis points ("BPS"), 100 BPS and 150 BPS. The analysis is shown as of December 31, 2014:

| Fair Value as of December 31, 2014 (in thousands) | | | | | |
|---|---|---|---|---|---|
| -150 BPS | -100 BPS | -50 BPS | +50 BPS | +100 BPS | +150 BPS |
| $499,791 | $499,276 | $497,704 | $491,957 | $489,026 | $486,095 |

Based on investment positions as of December 31, 2014, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $5.9 million incremental decline in the fair market value of the portfolio. As of December 31, 2013, a similar 100 basis point increase in the yield curve would have resulted in an $8.6 million incremental decline in the fair market value of the portfolio. Such losses would only be realized if the Company sold the investments prior to maturity.

As of December 31, 2014, we had $900.0 million of debt, consisting of fixed rate unsecured debt in two tranches: $500.0 million of 5.375% notes due in 2021; and $400.0 million of 5.750% notes due in 2024. The fair value of our debt will fluctuate with movements of interest rates, increasing in periods of declining rates of interest and declining in periods of increasing rates of interest.

Foreign Currency Risk

We have foreign currency risk related to our revenues and expenses denominated in currencies other than the U.S. dollar, primarily the Euro, the British Pound, the Canadian Dollar, and the Brazilian Real. Accordingly, changes in exchange rates may negatively affect our revenue and contribution profit (loss) of our International streaming segment as expressed in U.S. dollars.

We also have foreign currency risk related to foreign currency transactions and monetary assets and liabilities, including intercompany balances denominated in currencies that are not the functional currency. We have experienced and will continue to experience fluctuations in our net income as a result of gains (losses) on these foreign currency transactions and the remeasurement of monetary assets and liabilities.

We do not use foreign exchange contracts to hedge any foreign currency exposures. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. To date, the impacts of foreign currency exchange rate changes on our International streaming segment contribution profit (loss) and Consolidated net income have not been material. However, our continued international expansion increases our exposure to exchange rate fluctuations and as a result such fluctuations could have a significant impact on our future results of operations.

## Item 8. Financial Statements and Supplementary Data

The consolidated financial statements and accompanying notes listed in Part IV, Item 15(a)(1) of this Annual Report on Form 10-K are included immediately following Part IV hereof and incorporated by reference herein.

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(a) 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) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Annual Report on Form 10-K. 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 Annual Report on Form 10-K 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 recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

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 error 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.

(b) Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934 as amended (the Exchange Act)). Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control—Integrated Framework (2013 framework). Based on our assessment under the framework in Internal Control—Integrated Framework (2013 framework), our management concluded that our internal control over financial reporting was effective as of December 31, 2014. The effectiveness of our internal control over financial reporting as of December 31, 2014 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report that is included herein.

(c) Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Netflix, Inc.

We have audited Netflix, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Netflix, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Netflix, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Netflix, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2014 of Netflix, Inc. and our report dated January 29, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
San Jose, California
January 29, 2015

Item 9B. Other Information

None.

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## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

Information regarding our directors and executive officers is incorporated by reference from the information contained under the sections “Proposal One: Election of Directors,” “Section 16(a) Beneficial Ownership Compliance” and “Code of Ethics” in our Proxy Statement for the Annual Meeting of Stockholders.

### Item 11. Executive Compensation

Information required by this item is incorporated by reference from information contained under the section “Compensation of Executive Officers and Other Matters” in our Proxy Statement for the Annual Meeting of Stockholders.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by this item is incorporated by reference from information contained under the sections “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in our Proxy Statement for the Annual Meeting of Stockholders.

### Item 13. Certain Relationships and Related Transactions, and Director Independence

Information required by this item is incorporated by reference from information contained under the section “Certain Relationships and Related Transactions” and “Director Independence” in our Proxy Statement for the Annual Meeting of Stockholders.

### Item 14. Principal Accounting Fees and Services

Information with respect to principal independent registered public accounting firm fees and services is incorporated by reference from the information under the caption “Proposal Two: Ratification of Appointment of Independent Registered Public Accounting Firm” in our Proxy Statement for the Annual Meeting of Stockholders.

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PART IV

Item 15. Exhibits, Financial Statement Schedules
(a) The following documents are filed as part of this Annual Report on Form 10-K:
(1) Financial Statements:
The financial statements are filed as part of this Annual Report on Form 10-K under “Item 8. Financial Statements and Supplementary Data.”
(2) Financial Statement Schedules:
The financial statement schedules are omitted as they are either not applicable or the information required is presented in the financial statements and notes thereto under “Item 8. Financial Statements and Supplementary Data.”
(3) Exhibits:

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| Exhibit Number | Exhibit Description | Incorporated by Reference Form | File No. | Exhibit | Filing Date | Filed Herewith |
|---|---|---|---|---|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation | 10-Q | 000-49802 | 3.1 | August 2, 2004 | |
| 3.2 | Amended and Restated Bylaws | 8-K | 000-49802 | 3.1 | March 20, 2009 | |
| 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 | |
| 4.2 | Indenture, dated as of February 1, 2013, by and between the Company and Wells Fargo Bank, National Association, as Trustee. | 8-K | 001-35727 | 4.1 | February 1, 2013 | |
| 4.3 | Indenture, dated as of February 19, 2014, by and between the Company and Wells Fargo Bank, National Association, as Trustee. | 8-K | 001-35727 | 4.1 | February 19, 2014 | |
| 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† | Amended and Restated 2002 Stock Plan | Def 14A | 000-49802 | A | March 31, 2006 | |
| 10.3† | 2011 Stock Plan | Def 14A | 000-49802 | A | April 20, 2011 | |
| 10.4† | Amended and Restated Executive Severance and Retention Incentive Plan | 10-K | 000-49802 | 10.7 | February 1, 2013 | |
| 10.5 | Registration Rights Agreement, dated as of February 19, 2014, by and among the Company and Morgan Stanley & Co. LLC, as representative of the Initial Purchasers listed in Schedule 1 thereto | 8-K | 001-35727 | 10.1 | February 19, 2014 | |
| 10.6† | Performance Bonus Plan | Def 14A | 001-35727 | A | April 28, 2014 | |
| 21.1 | List of Significant Subsidiaries | | | | | X |
| 23.1 | Consent of Ernst & Young LLP | | | | | X |
| 24 | Power of Attorney (see signature page) | | | | | |
| 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 |
| 101 | The following financial information from Netflix, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on January 29, 2015, formatted in XBRL includes: (i) Consolidated Statements of Operations for the Years Ended December 31, 2014, 2013 and 2012, (ii) Consolidated Statements of Comprehensive Income for the Years Ended | | | | | X |

December 31, 2014, 2013 and 2012, (iii) Consolidated Statements of Cash Flows for the Years Ended December 31, 2014, 2013 and 2012, (iv) Consolidated Balance Sheets as of December 31, 2014 and 2013, (v) Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2014, 2013 and 2012 and (vi) the Notes to Consolidated Financial Statements.

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* 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.
† Indicates a management contract or compensatory plan

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NETFLIX, INC.
INDEX TO FINANCIAL STATEMENTS


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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Netflix, Inc.

We have audited the accompanying consolidated balance sheets of Netflix, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Netflix, Inc. at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Netflix, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and our report dated January 29, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
San Jose, California
January 29, 2015

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NETFLIX, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

| | Year ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Revenues | $5,504,656 | $4,374,562 | $3,609,282 |
| Cost of revenues | 3,752,760 | 3,117,203 | 2,652,058 |
| Marketing | 607,186 | 469,942 | 439,208 |
| Technology and development | 472,321 | 378,769 | 329,008 |
| General and administrative | 269,741 | 180,301 | 139,016 |
| Operating income | 402,648 | 228,347 | 49,992 |
| Other income (expense): | | | |
| Interest expense | (50,219) | (29,142) | (19,986) |
| Interest and other income (expense) | (3,060) | (3,002) | 474 |
| Loss on extinguishment of debt | — | (25,129) | — |
| Income before income taxes | 349,369 | 171,074 | 30,480 |
| Provision for income taxes | 82,570 | 58,671 | 13,328 |
| Net income | $266,799 | $112,403 | $17,152 |
| Earnings per share: | | | |
| Basic | $4.44 | $1.93 | $0.31 |
| Diluted | $4.32 | $1.85 | $0.29 |
| Weighted-average common shares outstanding: | | | |
| Basic | 60,078 | 58,198 | 55,521 |
| Diluted | 61,699 | 60,761 | 58,904 |

See accompanying notes to consolidated financial statements.

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NETFLIX, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

| | Year ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Net income | $266,799 | $112,403 | $17,152 |
| Other comprehensive income (loss): | | | |
| Foreign currency translation adjustments | (7,768) | 1,772 | 1,357 |
| Change in unrealized gains (losses) on available-for-sale securities, net of tax of $(156), $(697), and $538, respectively | (253) | (1,116) | 856 |
| Total other comprehensive income (loss) | (8,021) | 656 | 2,213 |
| Comprehensive income | $258,778 | $113,059 | $19,365 |

See accompanying notes to consolidated financial statements.

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NETFLIX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Cash flows from operating activities: | | | |
| Net income | $266,799 | $112,403 | $17,152 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Additions to streaming content library | (3,773,459) | (3,049,758) | (2,515,506) |
| Change in streaming content liabilities | 593,125 | 673,785 | 762,089 |
| Amortization of streaming content library | 2,656,279 | 2,121,981 | 1,591,218 |
| Amortization of DVD content library | 71,491 | 71,325 | 65,396 |
| Depreciation and amortization of property, equipment and intangibles | 54,028 | 48,374 | 45,469 |
| Stock-based compensation expense | 115,239 | 73,100 | 73,948 |
| Excess tax benefits from stock-based compensation | (89,341) | (81,663) | (4,543) |
| Other non-cash items | 15,282 | 5,332 | (8,392) |
| Loss on extinguishment of debt | — | 25,129 | — |
| Deferred taxes | (30,063) | (22,044) | (30,071) |
| Changes in operating assets and liabilities: | | | |
| Other current assets | (8,758) | 62,234 | (5,432) |
| Accounts payable | 83,812 | 18,374 | (4,943) |
| Accrued expenses | 55,636 | 1,941 | 9,806 |
| Deferred revenue | 58,819 | 46,295 | 20,676 |
| Other non-current assets and liabilities | (52,406) | (8,977) | 4,719 |
| Net cash provided by operating activities | 16,483 | 97,831 | 21,586 |
| Cash flows from investing activities: | | | |
| Acquisition of DVD content library | (74,790) | (65,927) | (48,275) |
| Purchases of property and equipment | (69,726) | (54,143) | (40,278) |
| Other assets | 1,334 | 5,939 | 8,816 |
| Purchases of short-term investments | (426,934) | (550,264) | (477,321) |
| Proceeds from sale of short-term investments | 385,300 | 347,502 | 282,953 |
| Proceeds from maturities of short-term investments | 141,950 | 60,925 | 29,365 |
| Net cash used in investing activities | (42,866) | (255,968) | (244,740) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of common stock | 60,544 | 124,557 | 4,124 |
| Proceeds from public offering of common stock, net of issuance costs | — | — | (464) |
| Proceeds from issuance of debt | 400,000 | 500,000 | — |
| Debt issuance costs | (7,080) | (9,414) | (295) |
| Redemption of debt | — | (219,362) | — |
| Excess tax benefits from stock-based compensation | 89,341 | 81,663 | 4,543 |
| Principal payments of lease financing obligations | (1,093) | (1,180) | (2,319) |
| Net cash provided by financing activities | 541,712 | 476,264 | 5,589 |
| Effect of exchange rate changes on cash and cash equivalents | (6,686) | (3,453) | (197) |
| Net increase (decrease) in cash and cash equivalents | 508,643 | 314,674 | (217,762) |
| Cash and cash equivalents, beginning of year | 604,965 | 290,291 | 508,053 |
| Cash and cash equivalents, end of year | $1,113,608 | $604,965 | $290,291 |
| Supplemental disclosure: | | | |
| Income taxes paid | $50,573 | $7,465 | $28,853 |

| | | | |
|---|---|---|---|
| Interest paid | 41,085 | 19,114 | 19,009 |

See accompanying notes to consolidated financial statements.

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NETFLIX, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

| | As of December 31, 2014 | 2013 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $1,113,608 | $604,965 |
| Short-term investments | 494,888 | 595,440 |
| Current content library, net | 2,125,702 | 1,706,421 |
| Other current assets | 206,271 | 151,937 |
| Total current assets | 3,940,469 | 3,058,763 |
| Non-current content library, net | 2,773,326 | 2,091,071 |
| Property and equipment, net | 149,875 | 133,605 |
| Other non-current assets | 192,981 | 129,124 |
| Total assets | $7,056,651 | $5,412,563 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Current content liabilities | $2,117,241 | $1,775,983 |
| Accounts payable | 201,581 | 108,435 |
| Accrued expenses | 69,746 | 54,018 |
| Deferred revenue | 274,586 | 215,767 |
| Total current liabilities | 2,663,154 | 2,154,203 |
| Non-current content liabilities | 1,575,832 | 1,345,590 |
| Long-term debt | 900,000 | 500,000 |
| Other non-current liabilities | 59,957 | 79,209 |
| Total liabilities | 5,198,943 | 4,079,002 |
| Commitments and contingencies (Note 6) | | |
| Stockholders' equity: | | |
| Preferred stock, $0.001 par value; 10,000,000 shares authorized at December 31, 2014 and 2013; no shares issued and outstanding at December 31, 2014 and 2013 | — | — |
| Common stock, $0.001 par value; 160,000,000 shares authorized at December 31, 2014 and 2013; 60,415,841 and 59,607,001 issued and outstanding at December 31, 2014 and 2013, respectively | 60 | 60 |
| Additional paid-in capital | 1,042,810 | 777,441 |
| Accumulated other comprehensive (loss) income | (4,446) | 3,575 |
| Retained earnings | 819,284 | 552,485 |
| Total stockholders' equity | 1,857,708 | 1,333,561 |
| Total liabilities and stockholders' equity | $7,056,651 | $5,412,563 |

See accompanying notes to consolidated financial statements.

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NETFLIX, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share data)

| | Common Stock | | Additional Paid-in Capital | Accumulated Other Comprehensive (Loss) Income | Retained Earnings | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| | Shares | Amount | | | | |
| Balances as of December 31, 2011 | 55,398,615 | $55 | $219,119 | $ 706 | $422,930 | $642,810 |
| Net income | — | — | — | — | 17,152 | 17,152 |
| Other comprehensive income | — | — | — | 2,213 | — | 2,213 |
| Issuance of common stock upon exercise of options | 188,552 | 1 | 4,123 | — | — | 4,124 |
| Stock-based compensation expense | — | — | 73,948 | — | — | 73,948 |
| Excess stock option income tax benefits | — | — | 4,426 | — | — | 4,426 |
| Balances as of December 31, 2012 | 55,587,167 | $56 | $301,616 | $ 2,919 | $440,082 | $744,673 |
| Net income | — | — | — | — | 112,403 | 112,403 |
| Other comprehensive income | — | — | — | 656 | — | 656 |
| Issuance of common stock upon exercise of options | 1,688,774 | 2 | 124,555 | — | — | 124,557 |
| Note conversion | 2,331,060 | 2 | 198,206 | — | — | 198,208 |
| Stock-based compensation expense | — | — | 73,100 | — | — | 73,100 |
| Excess stock option income tax benefits | — | — | 79,964 | — | — | 79,964 |
| Balances as of December 31, 2013 | 59,607,001 | $60 | $777,441 | $ 3,575 | $552,485 | $1,333,561 |
| Net income | — | — | — | — | 266,799 | 266,799 |
| Other comprehensive loss | — | — | — | (8,021) | — | (8,021) |
| Issuance of common stock upon exercise of options | 808,840 | — | 61,190 | — | — | 61,190 |
| Stock-based compensation expense | — | — | 115,239 | — | — | 115,239 |
| Excess stock option income tax benefits | — | — | 88,940 | — | — | 88,940 |
| Balances as of December 31, 2014 | 60,415,841 | $60 | $1,042,810 | $ (4,446) | $819,284 | $1,857,708 |

See accompanying notes to consolidated financial statements.

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NETFLIX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Description of Business

Netflix, Inc. (the "Company") was incorporated on August 29, 1997 and began operations on April 14, 1998. The Company is the world's leading Internet television network with over 57 million members in nearly 50 countries enjoying more than two billion hours of TV shows and movies per month, including original series, documentaries and feature films. Members can watch as much as they want, anytime, anywhere, on nearly any Internet-connected screen. Members can play, pause and resume watching, all without commercials or commitments. Additionally, in the United States ("U.S."), members can receive DVDs.

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

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant items subject to such estimates and assumptions include the amortization policy for the streaming content library; the recognition and measurement of income tax assets and liabilities; and the valuation of stock-based compensation. The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances. Actual results may differ from these estimates.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606) which amended the existing accounting standards for revenue recognition. ASU 2014-09 establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration to be received in exchange for those goods or services. It is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements, but does not expect the impact to be material.

Cash Equivalents and Short-term Investments

The Company considers investments in instruments purchased with an original maturity of 90 days or less to be cash equivalents. The Company also classifies amounts in transit from payment processors for customer credit card and debit card transactions as cash equivalents.

The Company classifies short-term investments, which consist of marketable securities with original maturities in excess of 90 days as available-for-sale. Short-term investments are reported at fair value with unrealized gains and losses included in "Accumulated other comprehensive (loss) income" within Stockholders' equity in the Consolidated Balance Sheets. 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 (expense)" in the 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.

Short-term investments are reviewed periodically to identify possible other-than-temporary impairment. When evaluating the investments, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer, the Company’s intent to sell, or whether it would be more likely than not that the Company would be required to sell the investments before the recovery of their amortized cost basis.

Streaming Content
The Company licenses and acquires rights to stream TV shows, movies and original content to members for unlimited viewing. These rights are for a fixed fee and specify windows of availability. Payment terms for certain content agreements require more up-front cash relative to expense.

The Company capitalizes the fee per title and records a corresponding liability at the gross amount of liabilities when the license period begins, the cost of the title is known and the title is accepted and available for streaming. The portion available for streaming within one year is recognized as “Current content library, net” and the remaining portion as “Non-current content library, net” on the Consolidated Balance Sheets. The acquisition of streaming content rights and the changes in related liabilities, are classified within cash used in operating activities on the Consolidated Statements of Cash Flows.

The Company amortizes the content library in “Cost of revenues” on a straight line or on an accelerated basis, as appropriate:

- For content that does not premiere on the Netflix service (representing the vast majority of content), the Company amortizes on a straight-line basis over the shorter of each title’s contractual window of availability or estimated period of use, beginning with the month of first availability. The amortization period typically ranges from six months to five years.

- For content that premieres on the Netflix service, the Company expects more upfront viewing due to the additional merchandising and marketing efforts for this original content available only on Netflix. Hence, the Company amortizes on an accelerated basis over the amortization period, which is the shorter of four years or the license period, beginning with the month of first availability. If a subsequent season is added, the amortization period is extended by a year.

- If the cost per title cannot be reasonably estimated, the license fee is not capitalized and costs are expensed on a straight line basis over the license period. This typically occurs when the license agreement does not specify the number of titles, the license fee per title or the windows of availability per title.

The content library is stated at the lower of unamortized cost or net realizable value. Streaming content (whether capitalized or not) is reviewed in aggregate at the geographic region level for impairment when an event or change in circumstances indicates a change in the expected usefulness of the content. The level of geographic aggregation is determined based on the streaming content rights which are generally specific to a geographic region inclusive of several countries (such as Latin America). No material write down from unamortized cost to a lower net realizable value was recorded in any of the periods presented.

DVD Content Library
The Company acquires DVD content for the purpose of renting such content to its members and earning membership rental revenues, and, as such, the Company considers its direct purchase DVD library to be a productive asset. Accordingly, the Company classifies its DVD library in “Non-current content library, net” on the Consolidated Balance Sheets. The acquisition of DVD content library, net of changes in related liabilities, is classified within cash used in investing activities on the Consolidated Statements of Cash Flows because the DVD content library is considered a productive asset. Other companies in the in-home entertainment video industry classify these cash flows as operating activities. The Company amortizes its direct purchase DVDs on an accelerated basis over their estimated useful lives, which range from one year to two years. The Company also obtains DVD content through revenue sharing agreements with studios and other content providers. Revenue sharing obligations are expensed as incurred based on shipments.
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 30 years, or the lease term for leasehold improvements, if applicable. Leased buildings are capitalized and included in property and equipment when the Company was involved in the construction funding and did not meet the “sale-leaseback” criteria.

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Impairment of Long-Lived Assets

Long-lived assets such as DVD content library, property and equipment and intangible assets subject to depreciation and 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. There were no events or changes in circumstances that would indicate that the carrying amount of an asset group may not be recoverable in any of the years presented.

Revenue Recognition

Revenues are recognized ratably over each monthly membership period. Revenues are presented net of the taxes that are collected from members and remitted to governmental authorities. Deferred revenue consists of membership fees billed to members that have not been recognized and gift and other prepaid memberships that have not been redeemed.

Marketing

Marketing expenses consist primarily of advertising expenses and also include payments made to the Company’s affiliates and consumer electronics partners. Advertising expenses include promotional activities such as television and online advertising. Advertising costs are expensed as incurred. Advertising expenses were $533.1 million, $404.0 million and $351.0 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Income Taxes

The Company records a provision for income taxes for the anticipated tax consequences of the reported results of operations 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 as well as net 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. There was no significant valuation allowance as of December 31, 2014 or 2013.

The Company did not recognize certain tax benefits from uncertain tax positions within the provision for income taxes. The Company may recognize a tax benefit only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. See Note 10 to the consolidated financial statements for further information regarding income taxes.

Foreign Currency

The Company translates the assets and liabilities of its non-U.S. dollar functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenues and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses from these translations are recognized in cumulative translation adjustment included in "Accumulated other comprehensive (loss) income" in Stockholders’ equity on the Consolidated Balance Sheets.

The Company remeasures monetary assets and liabilities that are not denominated in the functional currency at exchange rates in effect at the end of each period. Gains and losses from these remeasurements are recognized in interest and other income (expense). Foreign currency transactions resulted in losses of $8.2 million, $8.4 million, and $4.0 million for the years ended December 31, 2014, 2013, and 2012 respectively.

Earnings Per Share

Basic earnings per share is computed using the weighted-average number of outstanding shares of common stock during the period. Diluted earnings per share is computed using the weighted-average number of outstanding shares of common stock and, when dilutive, potential common shares outstanding during the period. Potential common shares consist of shares issuable upon the assumed conversion of the Company’s Convertible Notes (prior to the conversion of such notes in April 2013) and incremental shares issuable upon the assumed exercise of stock options. The computation of earnings per share is as follows:

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| | Year ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | (in thousands, except per share data) | | |
| Basic earnings per share: | | | |
| Net income | $266,799 | $112,403 | $17,152 |
| Shares used in computation: | | | |
| Weighted-average common shares outstanding | 60,078 | 58,198 | 55,521 |
| Basic earnings per share | $4.44 | $1.93 | $0.31 |
| Diluted earnings per share: | | | |
| Net income | $266,799 | $112,403 | $17,152 |
| Convertible Notes interest expense, net of tax | — | 49 | 195 |
| Numerator for diluted earnings per share | 266,799 | 112,452 | 17,347 |
| Shares used in computation: | | | |
| Weighted-average common shares outstanding | 60,078 | 58,198 | 55,521 |
| Convertible Notes shares | — | 715 | 2,331 |
| Employee stock options | 1,621 | 1,848 | 1,052 |
| Weighted-average number of shares | 61,699 | 60,761 | 58,904 |
| Diluted earnings per share | $4.32 | $1.85 | $0.29 |

Employee stock options with exercise prices greater than the average market price of the common stock were excluded from the diluted calculation as their inclusion would have been anti-dilutive. The following table summarizes the potential common shares excluded from the diluted calculation:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | (in thousands) | | |
| Employee stock options | 131 | 198 | 1,207 |

Stock-Based Compensation

The Company grants fully vested non-qualified stock options to its employees on a monthly basis. As a result of immediate vesting, stock-based compensation expense is fully recognized on the grant date, and no estimate is required for post-vesting option forfeitures. See Note 8 to the consolidated financial statements for further information regarding stock-based compensation.

2. Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation in the consolidated financial statements.

Costs of revenues in the amount of $33.9 million and $26.2 million for the years ended December 31, 2013 and 2012, respectively, related to free-trial periods that were previously allocated to “Marketing” on the Consolidated Statements of Operations have been reallocated to “Cost of revenues”. There was no impact in any period presented to contribution profit or net income or to the Consolidated Balance Sheets or Consolidated Statements of Cash Flows.

3. Short-term Investments

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

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

| | As of December 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| | (in thousands) | | | |
| Cash | $483,959 | $— | $— | $483,959 |
| Level 1 securities: | | | | |
| Money market funds | 126,208 | — | — | 126,208 |
| Level 2 securities: | | | | |
| Corporate debt securities | 316,465 | 1,245 | (654) | 317,056 |
| Government securities | 143,812 | 287 | (18) | 144,081 |
| Asset and mortgage-backed securities | 93,118 | 229 | (418) | 92,929 |
| Certificate of deposits | 23,425 | — | — | 23,425 |
| Agency securities | 17,951 | — | (2) | 17,949 |
| Total | $1,204,938 | $1,761 | $(1,092) | $1,205,607 |

| | As of December 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| Cash and cash equivalents | $1,113,608 | $604,965 |
| Short-term investments | 494,888 | 595,440 |
| Non-current assets (1) | 5,694 | 5,202 |
| Total | $1,614,190 | $1,205,607 |

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

Fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. The hierarchy level assigned to each security in the Company's available-for-sale portfolio and cash equivalents is based on its assessment of the transparency and reliability of the inputs used in the valuation of such instrument at the measurement date. The fair value of available-for-sale securities and cash equivalents included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. The fair value of available-for-sale securities included in the Level 2 category is based on observable inputs, such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. These values were obtained from an independent pricing service and were evaluated using pricing models that

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vary by asset class and may incorporate available trade, bid and other market information and price quotes from well-established independent pricing vendors and broker-dealers. The Company's procedures include controls to ensure that appropriate fair values are recorded, such as comparing prices obtained from multiple independent sources. See Note 5 to the consolidated financial statements for further information regarding the fair value of the Company's senior convertible notes and senior notes.

Because the Company does not intend to sell the investments that are in an unrealized loss position and it is not likely that the Company will be required to sell any investments before recovery of their amortized cost basis, the Company does not consider those investments with an unrealized loss to be other-than-temporarily impaired at December 31, 2014. There were no material other-than-temporary impairments or credit losses related to available-for-sale securities in the years ended December 31, 2014, 2013 or 2012.

There were no material gross realized gains or losses from the sale of available-for-sale investments in the years ended December 31, 2014, 2013 and 2012. Realized gains and losses and interest income are included in interest and other income.

The estimated fair value of short-term investments by contractual maturity as of December 31, 2014 is as follows:

| | (in thousands) |
|---|---|
| Due within one year | $113,864 |
| Due after one year and through 5 years | 381,024 |
| Total short-term investments | $494,888 |

4. Balance Sheet Components

Content Library

Content library consisted of the following:

| | As of December 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| Total content library, gross | $8,497,403 | $6,474,688 |
| Accumulated amortization | (3,598,375 ) | (2,677,196 ) |
| Total content library, net | 4,899,028 | 3,797,492 |
| Current content library, net | 2,125,702 | 1,706,421 |
| Non-current content library, net | $2,773,326 | $2,091,071 |

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Property and Equipment, Net

Property and equipment and accumulated depreciation consisted of the following:

| | As of December 31, | | Estimated Useful |
|---|---|---|---|
| | 2014 | 2013 | Lives (in Years) |
| | (in thousands) | | |
| Information technology assets | $189,274 | $139,306 | 3 years |
| Furniture and fixtures | 25,758 | 21,011 | 3 years |
| Building | 40,681 | 40,681 | 30 years |
| Leasehold improvements | 57,339 | 51,194 | Over life of lease |
| DVD operations equipment | 89,144 | 96,361 | 5 years |
| Capital work-in-progress | 12,495 | 8,643 | |
| Property and equipment, gross | 414,691 | 357,196 | |
| Less: Accumulated depreciation | (264,816) | (223,591) | |
| Property and equipment, net | $149,875 | $133,605 | |

As of December 31, 2014 and 2013, the Company had unpaid property and equipment included in accounts payable of $11.8 million and $6.8 million, respectively on the Consolidated Balance Sheets, and consequently such amounts are excluded from purchases of property and equipment on the Consolidated Statements of Cash Flows for the years ended December 31, 2014 and 2013.

5. Long-term Debt

Senior Convertible Notes

In November 2011, the Company issued $200.0 million aggregate principal amount of zero coupon senior convertible notes due on December 1, 2018 (the “Convertible Notes”) in a private placement offering to TCV VII, L.P., TCV VII(A), L.P., and TCV Member Fund, L.P. A general partner of these funds also serves on the Company’s Board of Directors, and as such, the issuance of the notes is considered a related party transaction. The net proceeds to the Company were approximately $197.8 million. Debt issuance costs of $2.2 million (of which $0.3 million was paid in the year ended December 31, 2012) were recorded in “Other non-current assets” on the Consolidated Balance Sheets and were amortized over the term of the notes as interest expense. At any time following May 28, 2012, the Company could have elected to cause the conversion of the Convertible Notes into shares of the Company’s common stock when specified conditions were satisfied, including that the daily volume weighted average price of the Company’s common stock was equal to or greater than $111.54 for at least 50 trading days during a 65 trading day period prior to the conversion date.

The Company determined that the embedded conversion option in the Convertible Notes did not require separate accounting treatment as a derivative instrument because it was both indexed to the Company's own stock and would be classified in stockholders' equity if freestanding. Additionally, the Convertible Notes did not require or permit any portion of the obligation to be settled in cash and accordingly the liability and equity (conversion option) components were not required to be accounted for separately.

In April 2013, after all specified conditions were satisfied, the Company elected to cause the conversion of all outstanding Convertible Notes with an aggregate principal amount of $200.0 million in accordance with the terms of the Indenture governing such notes. Pursuant to this conversion, the Company issued 2.3 million shares of common stock to the holders of the Convertible Notes at a conversion ratio of 11.6553. The fair market value of one share of common stock on the date of conversion was $216.99 per share.

8.50% Senior Notes

In November 2009, the Company issued $200.0 million aggregate principal amount of 8.50% senior notes due November 15, 2017 (the “8.50% Notes”). The net proceeds to the Company were approximately $193.9 million.

Debt issuance costs of $6.1 million were recorded in “Other non-current assets” on the Consolidated Balance Sheets and were amortized over the term of the notes as interest expense. The notes were issued at par and were senior unsecured obligations of the Company. Interest was payable semi-annually at a rate of 8.50% per annum on May 15 and November 15 of each year, commencing on May 15, 2010. The 8.50% Notes were repayable in whole or in part upon the occurrence of a change of control, at the option of the holders, at a purchase price in cash equal to 101% of the principal plus accrued interest. The

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Company could redeem the 8.50% Notes prior to November 15, 2013 in whole or in part at a redemption price of 100% of the principal plus accrued interest, plus a “make-whole” premium.

In the first quarter of 2013, the Company redeemed the outstanding $200.0 million aggregate principal amount of 8.50% Notes and pursuant to the make-whole provision in the Indenture governing the 8.50% Notes, paid a $19.4 million premium and $5.1 million of accrued and unpaid interest. The Company recognized a loss on extinguishment of debt of $25.1 million related to redemption of the 8.50% Notes which included the write off of unamortized debt issuance costs of $4.2 million.

5.375% Senior Notes

In February 2013, the Company issued $500.0 million aggregate principal amount of 5.375% senior notes due 2021 (the “5.375% Notes”). The 5.375% Notes were issued at par and are senior unsecured obligations of the Company. Interest is payable semi-annually at a rate of 5.375% per annum on February 1 and August 1 of each year, commencing on August 1, 2013. The 5.375% Notes are repayable in whole or in part upon the occurrence of a change of control, at the option of the holders, at a purchase price in cash equal to 101% of the principal plus accrued interest. The Company may redeem the 5.375% Notes prior to maturity in whole or in part at an amount equal to the principal amount thereof plus accrued and unpaid interest plus a make-whole payment equivalent to the present value of the remaining interest payments through maturity.

The 5.375% Notes include, among other terms and conditions, limitations on the Company's ability to create, incur or allow certain liens; enter into sale and lease-back transactions; create, assume, incur or guarantee additional indebtedness of the Company's subsidiaries; and consolidate or merge with, or convey, transfer or lease all or substantially all of the Company's and its subsidiaries assets, to another person. At December 31, 2014 the Company was in compliance with these covenants.

In the first quarter of 2013, the Company used $224.5 million of the net proceeds of the 5.375% Notes to redeem the outstanding $200.0 million aggregate principal amount of 8.50% Notes.

Based on quoted market prices in less active markets (a Level 2 input for this financial instrument), the fair value of the 5.375% Notes was $520.0 million and  $506.3 million as of December 31, 2014 and 2013 respectively.

5.750% Senior Notes

In February 2014, the Company issued $400.0 million aggregate principal amount of 5.750% Senior Notes due 2024 (the "5.750% Notes"). The 5.750% Notes were issued at par and are senior unsecured obligations of the Company. Interest is payable semi-annually at a rate of 5.750% per annum on March 1 and September 1 of each year, commencing on September 1, 2014. The 5.750% Notes are repayable in whole or in part upon the occurrence of a change of control, at the option of the holders, at a purchase price in cash equal to 101% of the principal plus accrued interest. The Company may redeem the 5.750% Notes prior to maturity in whole or in part at an amount equal to the principal amount thereof plus accrued and unpaid interest plus a make-whole payment equivalent to the present value of the remaining interest payments through maturity.

The 5.750% Notes include, among other terms and conditions, limitations on the Company's ability to create, incur or allow certain liens; enter into sale and lease-back transactions; create, assume, incur or guarantee additional indebtedness of the Company's subsidiaries; and consolidate or merge with, or convey, transfer or lease all or substantially all of the Company's and its subsidiaries assets, to another person. At December 31, 2014, the Company was in compliance with these covenants.

Based on quoted market prices in less active markets (a Level 2 input for this financial instrument), the fair value of the 5.750% Notes as of December 31, 2014 was $416.0 million.

6. Commitments and Contingencies

Streaming Content

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

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At December 31, 2013, the Company had $7.3 billion of obligations comprised of $1.8 billion included in "Current content liabilities" and $1.3 billion of "Non-current content liabilities" on the Consolidated Balance Sheets and $4.2 billion of obligations that are not reflected on the Consolidated Balance Sheet.
The expected timing of payments for these streaming content obligations is as follows:

| | As of December 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| Less than one year | $3,747,648 | $2,972,325 |
| Due after one year and through 3 years | 4,495,103 | 3,266,907 |
| Due after 3 years and through 5 years | 1,164,308 | 929,645 |
| Due after 5 years | 44,053 | 83,284 |
| Total streaming content obligations | $9,451,112 | $7,252,161 |

A streaming content obligation is incurred at the time the Company enters into an agreement to obtain future titles. Once a title becomes available, a content liability is generally recorded on the Consolidated Balance Sheets. Certain agreements include the obligation to license rights for unknown future titles, the ultimate quantity and / or fees for which are not yet determinable as of the reporting date. Because the amount is not reasonably estimable, the Company does not include any estimated obligation for these future titles beyond the known minimum amount. However, the unknown obligations are expected to be significant and the expected timing of payments could range from less than one year to more than five years.
The Company has entered into certain licenses with performing rights organizations ("PROs"), and is currently involved in negotiations with other PROs, that hold certain rights to music and other entertainment works "publicly performed" in connection with streaming content into various territories. Accruals for estimated license fees are recorded and then adjusted based on any change in estimates. These amounts are included in the streaming content obligations. The results of these negotiations are uncertain and may be materially different from management's estimates.

Lease obligations
The Company leases facilities under non-cancelable operating leases with various expiration dates through 2019. Several lease agreements contain rent escalation clauses or rent holidays. For purposes of recognizing minimum rental expenses on a straight-line basis over the terms of the leases, the Company uses the date of initial possession to begin amortization, which is generally when the Company enters the space and begins to make improvements in preparation for intended use. For scheduled rent escalation clauses during the lease terms or for rental payments commencing at a date other than the date of initial occupancy, the Company records minimum rental expenses on a straight-line basis over the terms of the leases in the Consolidated Statements of Operations. The Company has the option to extend or renew most of its leases which may increase the future minimum lease commitments.
Because the terms of the Company's original facilities lease agreements for its current Los Gatos, California headquarters site required the Company's involvement in the construction funding of the buildings, the Company is the "deemed owner" (for accounting purposes only) of these buildings. Accordingly, the Company recorded an asset of $40.7 million, representing the total costs of the buildings and improvements, including the costs paid by the lessor (the legal owner of the buildings), with corresponding liabilities. Upon completion of construction of each building, the Company did not meet the sale-leaseback criteria for de-recognition of the building assets and liabilities. Therefore the leases are accounted for as financing obligations.
In the first quarter of 2010, the Company extended the facilities leases for the current Los Gatos buildings for an additional five year term after the remaining term of the original lease, thus increasing the future minimum payments under lease financing obligations by approximately $14 million. The leases continue to be accounted for as financing obligations and no gain or loss was recorded as a result of the lease financing modification. At December 31, 2014,

the lease financing obligation balance was $29.6 million, of which $1.2 million and $28.4 million were recorded in "Accrued expenses" and "Other non-current liabilities," respectively, on the Consolidated Balance Sheets. The remaining future minimum payments under the lease financing obligation are $9.4 million. The lease financing obligation balance at the end of the extended lease term will be approximately $25.8 million which approximates the net book value of the buildings to be relinquished to the lessor.

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In the third quarter of 2013, the Company entered into facilities lease agreements to expand its Los Gatos headquarters. At the time the Company entered into these lease agreements, the prior agreement signed in the fourth quarter of 2012 was simultaneously terminated. The 124 month lease term for each of the new leases will commence after the construction of the buildings is complete. Future minimum lease payments associated with these leases are $122.2 million as of December 31, 2014 and are included below.
Future minimum payments under lease financing obligations and non-cancelable operating leases as of December 31, 2014 are as follows:

| Year Ending December 31, | Future Minimum Payments (in thousands) |
|---|---|
| 2015 | $35,501 |
| 2016 | 37,078 |
| 2017 | 27,697 |
| 2018 | 19,804 |
| 2019 | 14,923 |
| Thereafter | 76,130 |
| Total minimum payments | $211,133 |

Rent expense associated with the operating leases was $26.6 million, $27.9 million and $29.7 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Legal Proceedings

From time to time, in the normal course of its operations, the Company is subject to litigation matters and claims, including claims relating to employee relations, business practices and patent infringement. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict and the Company's view of these matters may change in the future as the litigation and events related thereto unfold. The Company expenses legal fees as incurred. The Company records a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. An unfavorable outcome to any legal matter, if material, could have an adverse effect on the Company's operations or its financial position, liquidity or results of operations.
On January 13, 2012, the first of three purported shareholder class action lawsuits was filed in the United States District Court for the Northern District of California against the Company and certain of its officers and directors. Two additional purported shareholder class action lawsuits were filed in the same court on January 27, 2012 and February 29, 2012 alleging substantially similar claims. These lawsuits were consolidated into In re Netflix, Inc., Securities Litigation, Case No. 3:12-cv-00225-SC, and the Court selected lead plaintiffs. On June 26, 2012, lead plaintiffs filed a consolidated complaint which alleged violations of the federal securities laws. The Court dismissed the consolidated complaint with leave to amend on February 13, 2013. Lead plaintiffs filed a first amended consolidated complaint on March 22, 2013. The Court dismissed the first amended consolidated complaint with prejudice on August 20, 2013, and judgment was entered on September 27, 2013. Lead plaintiffs filed a motion to alter or amend the judgment and requested leave to file a second amended complaint on October 25, 2013. On January 17, 2014, the Court denied that motion. On February 18, 2014, lead plaintiffs appealed that decision to the United States Court of Appeals for the Ninth Circuit. Management has determined a potential loss is reasonably possible however, based on its current knowledge, management does not believe that the amount of such possible loss or a range of potential loss is reasonably estimable
On November 23, 2011, the first of six purported shareholder derivative suits was filed in the Superior Court of California, Santa Clara County, against the Company and certain of its officers and directors. Five additional purported shareholder derivative suits were subsequently filed: two in the Superior Court of California, Santa Clara County on February 9, 2012 and May 2, 2012; and three in the United States District Court for the Northern District of

California on February 13, 2012, February 24, 2012 and April 2, 2012. The purported shareholder derivative suits filed in the Northern District of California have been voluntarily dismissed. On July 5, 2012, the purported shareholder derivative suits filed in Santa Clara County were consolidated into In re Netflix, Inc. Shareholder Derivative Litigation, Case No. 1-12-cv-218399, and lead counsel was appointed. A consolidated complaint was filed on December 4, 2012, with plaintiffs seeking compensatory damages and other relief. The consolidated complaint alleges, among other things, that certain of the Company's current and former officers and directors breached their fiduciary duties, issued false and misleading statements primarily regarding the Company's streaming business, violated accounting rules concerning segment reporting, violated provisions of the California Corporations

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Code, and wasted corporate assets. The consolidated complaint further alleges that the defendants caused the Company to buy back stock at artificially inflated prices to the detriment of the Company and its shareholders while contemporaneously selling personally held Company stock. The Company filed a demurrer to the consolidated complaint and a motion to stay the derivative litigation in favor of the related federal securities class action on February 4, 2013. On June 21, 2013, the Court granted the motion to stay the derivative litigation pending resolution of the related federal securities class action. Management has determined a potential loss is reasonably possible however, based on its current knowledge, management does not believe that the amount of such possible loss or a range of potential loss is reasonably estimable.

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

7. Guarantees—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 may be conditional on the other party making a claim pursuant to the procedures specified in the particular contract.

The Company's obligations under these agreements may be limited in terms of time or amount, and in some instances, the Company may have recourse against third parties for certain payments. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers that will require it, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. The terms of such obligations vary.

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

8. Stockholders' Equity

On November 2, 2012, the Board of Directors (the "Board") of the Company authorized and declared a dividend distribution of one right (a "Right") for each outstanding share of common stock, par value $0.001 per share (the "Common Shares"), of the Company to stockholders of record at the close of business on November 12, 2012 (the "Record Date"). Each Right entitled the registered holder to purchase from the Company one one-thousandth of a share of Series A Participating Preferred Stock, par value $0.001 per share (the "Preferred Shares"), of the Company at an exercise price of $350 per one one-thousandth of a Preferred Share, subject to adjustment (the "Exercise Price"). The Rights were exercisable in the event any person or group acquires 10% (or 20% in the case of certain institutional investors who report their holdings on Schedule 13G) or more of the Common Shares without the approval of the Board, and until such time are inseparable from and trade with the Company's common stock. The Rights had a de minimus fair value. The Rights Agreement was amended on December 30, 2013 to accelerate the expiration of the Rights from the close of business on November 2, 2015 to the close of business on December 30, 2013, and had the effect of terminating the Rights Agreement on that date. At the time of the termination of the Rights Agreement, all of the Rights distributed to holders of the Company's common stock pursuant to the Rights Agreement expired.

In April 2013, the Company issued 2.3 million shares of common stock in connection with the conversion of the Convertible Notes. See Note 5 to the consolidated financial statements for further details.

Preferred Stock

In 2012, the Company designated 1,000,000 shares of its preferred stock with par value of $0.001 per share as Series A Participating Preferred Stock. The remaining 9,000,000 shares of preferred stock with par value of $0.001 remained undesignated. In connection with the expiration of the Rights and the termination of the Rights Agreement on

December 30, 2013, the shares that were designated to such series were returned to the status of authorized but unissued shares of preferred stock of the Company, and the Company therefore now has 10,000,000 shares of preferred stock with a par value of $0.001 that are undesignated.
None of the preferred shares were issued and outstanding at December 31, 2014 and 2013.

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Voting Rights

The holders of each share of common stock shall be entitled to one vote per share on all matters to be voted upon by the Company's stockholders.

Stock Option Plans

In June 2011, the Company adopted the 2011 Stock Plan. The 2011 Stock Plan provides for the grant of incentive stock options to employees and for the grant of non-statutory stock options, stock appreciation rights, restricted stock and restricted stock units to employees, directors and consultants. As of December 31, 2014, 2.9 million shares were reserved for future grants under the 2011 Stock Plan.

In February 2002, the Company adopted the 2002 Stock Plan, which was amended and restated in May 2006. The 2002 Stock Plan provided 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. In the first quarter of 2012, 1.2 million shares reserved for future grants under the 2002 Stock Plan expired.

A summary of the activities related to the Company's stock option plans is as follows:

| | Shares Available for Grant | Options Outstanding | | Weighted-Average Remaining Contractual Term (in Years) | Aggregate Intrinsic Value (in Thousands) |
|---|---|---|---|---|---|
| | | Number of Shares | Weighted-Average Exercise Price | | |
| Balances as of December 31, 2011 | 7,013,508 | 2,957,754 | $66.59 | | |
| Granted | (1,803,798) | 1,803,798 | 73.94 | | |
| Exercised | — | (188,552) | 21.85 | | |
| Canceled | 48 | (48) | 35.95 | | |
| Expired | (1,160,721) | — | | | |
| Balances as of December 31, 2012 | 4,049,037 | 4,572,952 | $71.33 | | |
| Granted | (642,720) | 642,720 | 208.94 | | |
| Exercised | — | (1,688,774) | 73.75 | | |
| Balances as of December 31, 2013 | 3,406,317 | 3,526,898 | $95.25 | | |
| Granted | (545,573) | 545,573 | 402.85 | | |
| Exercised | — | (808,840) | 75.65 | | |
| Balances as of December 31, 2014 | 2,860,744 | 3,263,631 | $151.53 | 6.14 | $654,673 |
| Vested and exercisable at December 31, 2014 | | 3,263,631 | $151.53 | 6.14 | $654,673 |

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 2014 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on the last trading day of 2014. This amount changes based on the fair market value of the Company's common stock. Total intrinsic value of options exercised for the years ended December 31, 2014, 2013 and 2012 was $265.1 million, $274.2 million and $14.7 million, respectively.

Cash received from option exercises for the years ended December 31, 2014, 2013 and 2012 was $60.5 million, $124.6 million and $4.1 million, respectively.

Employee Stock Purchase Plan

In February 2002, the Company adopted the 2002 ESPP under which employees purchased common stock of the Company through accumulated payroll deductions. The purchase price of the common stock acquired by the 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 was lower. Under the ESPP, the offering and purchase periods took place concurrently in consecutive six month increments. Therefore, the look-back for determining the purchase price was six months. Employees could invest up to 15% of their gross compensation through payroll deductions. In no event was an employee permitted to purchase more than 8,334 shares of common stock during any six-month purchase period.

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As of December 31, 2014, there were 2,785,721 shares available for future issuance under the 2002 Employee Stock Purchase Plan. The Company's ESPP was suspended in 2011 and there were no offerings subsequent to 2011.

Stock-Based Compensation

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 after January 2007 will remain exercisable for the full ten year contractual term regardless of employment status. The following table summarizes the assumptions used to value option grants using the lattice-binomial model and the valuation data:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Dividend yield | — % | — % | — % |
| Expected volatility | 41% - 48% | 51% - 54% | 55% - 65% |
| Risk-free interest rate | 2.39% - 2.83% | 1.87% - 2.71% | 1.61% - 2.01% |
| Suboptimal exercise factor | 2.66 - 5.44 | 2.33 - 3.92 | 2.26 - 3.65 |
| Valuation data: | | | |
| Weighted-average fair value (per share) | $211.22 | $113.74 | $41.00 |
| Total stock-based compensation expense (in thousands) | 115,239 | 73,100 | 73,948 |
| Total income tax benefit related to stock options (in thousands) | 43,999 | 28,096 | 28,537 |

The Company considers several factors in determining the suboptimal exercise factor including the historical and estimated option exercise behavior and the employee groupings.

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. Low trade volume of the Company's tradable forward call options prior to 2011 precluded sole reliance on implied volatility, and as such the Company includes historical volatility in the computation of expected volatility.

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

Stock Repurchase Program

Under the stock repurchase plan announced on June 11, 2010, the Company was authorized to repurchase up to $300 million of its common stock through the end of 2012. As of December 31, 2012, the Company has repurchased $259.0 million of its common stock under this plan. As of December 31, 2012, the plan has expired and the remaining $41.0 million was unused. There were no stock repurchases in 2012, 2013 or 2014.

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9. Accumulated Other Comprehensive (Loss) Income

The following table summarizes the changes in accumulated balances of other comprehensive (loss) income, net of tax:

| | Foreign currency | Change in unrealized gains on available-for-sale securities | Total |
|---|---|---|---|
| | (in thousands) | | |
| Balance as of December 31, 2012 | $1,381 | $ 1,538 | $2,919 |
| Other comprehensive income before reclassifications | 1,772 | (1,597) | 175 |
| Amounts reclassified from accumulated other comprehensive income | — | 481 | 481 |
| Net increase (decrease) in other comprehensive income | 1,772 | (1,116) | 656 |
| Balance as of December 31, 2013 | $3,153 | $ 422 | $3,575 |
| Other comprehensive (loss) income before reclassifications | (7,768) | 337 | (7,431) |
| Amounts reclassified from accumulated other comprehensive (loss)income | — | (590) | (590) |
| Net decrease in other comprehensive (loss) income | (7,768) | (253) | (8,021) |
| Balance as of December 31, 2014 | $(4,615) | $ 169 | $(4,446) |

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

10. Income Taxes

Income before provision for income taxes was as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | (in thousands) | | |
| United States | $325,081 | $159,126 | $27,885 |
| Foreign | 24,288 | 11,948 | 2,595 |
| Income before income taxes | $349,369 | $171,074 | $30,480 |

The components of provision for income taxes for all periods presented were as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | (in thousands) | | |
| Current tax provision: | | | |
| Federal | $86,623 | $58,558 | $34,387 |
| State | 9,866 | 15,154 | 7,850 |
| Foreign | 16,144 | 7,003 | 1,162 |
| Total current | 112,633 | 80,715 | 43,399 |
| Deferred tax provision: | | | |
| Federal | (10,994) | (18,930) | (26,903) |

| | | | |
|---|---|---|---|
| State | (17,794) | (2,751) | (3,168) |
| Foreign | (1,275) | (363) | — |
| Total deferred | (30,063) | (22,044) | (30,071) |
| Provision for income taxes | $82,570 | $58,671 | $13,328 |

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U.S. income taxes and foreign withholding taxes associated with the repatriation of earnings of foreign subsidiaries were not provided for on a cumulative total of $29.2 million of undistributed earnings for certain foreign subsidiaries as of December 31, 2014. The Company intends to reinvest these earnings indefinitely in its foreign subsidiaries. If these earnings were distributed to the United States in the form of dividends or otherwise, the Company would be subject to additional U.S. income taxes net of available foreign tax credits associated with these earnings. The amount of unrecognized deferred income tax liability related to these earnings is approximately $10.2 million.

Income tax benefits attributable to the exercise of employee stock options of $88.9 million, $80.0 million and $4.4 million for the years ended December 31, 2014, 2013 and 2012, respectively, were recorded directly to additional paid-in-capital.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate to income before income taxes is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | (in thousands) | | |
| Expected tax expense at U.S. federal statutory rate of 35% | $122,279 | $59,878 | $10,667 |
| State income taxes, net of Federal income tax effect | 13,274 | 8,053 | 2,914 |
| R&D tax credit | (18,655) | (13,841) | (1,803) |
| Release of tax reserves on previously unrecognized tax benefits | (38,612) | — | — |
| Other | 4,284 | 4,581 | 1,550 |
| Provision for income taxes | $82,570 | $58,671 | $13,328 |

The components of deferred tax assets and liabilities were as follows:

| | As of December 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| Deferred tax assets (liabilities): | | |
| Stock-based compensation | $100,397 | $69,201 |
| Accruals and reserves | 13,415 | 13,022 |
| Depreciation and amortization | (11,708) | (11,159) |
| R&D credits | 21,014 | 19,196 |
| Other | (2,778) | 824 |
| Total deferred tax assets | 120,340 | 91,084 |
| Valuation allowance | — | (481) |
| Net deferred tax assets | $120,340 | $90,603 |

Deferred tax assets include $13.4 million and $21.5 million classified as “Other current assets” and $106.9 million and $69.1 million classified as “Other non-current assets” in the Consolidated Balance Sheets as of December 31, 2014 and 2013, respectively. In evaluating its ability to realize the net deferred tax assets, the Company considered all available positive and negative evidence, including its past operating results and the forecast of future market growth, forecasted earnings, future taxable income, and prudent and feasible tax planning strategies. As of December 31, 2014 and 2013, it was considered more likely than not that substantially all deferred tax assets would be realized, and no significant valuation allowance was recorded.

As of December 31, 2014, the Company's state tax credit carryforwards for tax return purposes were $41.9 million, of which $41.1 million can be carried forward indefinitely and $0.8 million expire in 2024.

On December 19, 2014, the Tax Increase Prevention Act of 2014 (H.R.5771) was signed into law which retroactively extends the Federal research and development credit from January 1, 2014 through December 31, 2014. As a result, the Company recognized the retroactive benefit of the Federal research and development credit of approximately $10.7 million as a discrete item in the fourth quarter of 2014, the period in which the legislation was enacted.

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The Company classifies unrecognized tax benefits that are not expected to result in payment or receipt of cash within one year as “Other non-current liabilities” in the Consolidated Balance Sheets. As of December 31, 2014, the total amount of gross unrecognized tax benefits was $34.8 million, of which $29.2 million, if recognized, would favorably impact the Company’s effective tax rate. The aggregate changes in the Company’s total gross amount of unrecognized tax benefits are summarized as follows (in thousands):

| | | |
|---|---|---|
| Balance as of December 31, 2012 | $43,337 | |
| Increases related to tax positions taken during prior periods | 4 | |
| Decreases related to tax positions taken during prior periods | (25 | ) |
| Increases related to tax positions taken during the current period | 24,915 | |
| Balance as of December 31, 2013 | $68,231 | |
| Decreases related to tax positions taken during prior periods | (39,015 | ) |
| Increases related to tax positions taken during the current period | 11,174 | |
| Decreases related to settlements with taxing authorities | (5,578 | ) |
| Balance as of December 31, 2014 | $34,812 | |

The Company includes interest and penalties related to unrecognized tax benefits within the provision for income taxes. As of December 31, 2014 and December 31, 2013, the total amount of gross interest and penalties accrued was $0.4 million and $3.9 million, respectively, which is classified as “Other non-current liabilities” in the Consolidated Balance Sheets. Interest and penalties included in the Company's provision for income taxes were not material in all the periods presented.

The Company files U.S. federal, state and foreign tax returns. The Company is currently under examination by the IRS for the years 2010 through 2013. The IRS had previously completed its Field Exam of the 2008 and 2009 federal tax returns and issued a Revenue Agents Report with a proposed assessment primarily related to the Company's R&D Credits claimed in those years. The Company filed a protest against the proposed assessment and settlement was reached with the IRS Appeals Division in December 2014. As a result, the Company reassessed the tax reserves for all open years and released $38.6 million of tax reserves in the fourth quarter of 2014. The IRS Field Exam of the 2010 through 2013 federal tax returns is in progress.

The Company is also currently under examination by the state of California for the years 2006 and 2007. California has completed its Field Exam of the 2006 and 2007 California tax returns and has issued a Notice of Proposed Assessment primarily related to the Company's R&D Credits claimed in those years. The Company has filed a protest against the proposed assessment and is currently awaiting the commencement of the Protest process with the Franchise Tax Board. The years 1997 through 2005, as well as 2008 through 2013, remain subject to examination by the state of California.

The Company is currently not under examination in any foreign jurisdiction. The years 2011 through 2013 remain subject to examination by foreign jurisdictions.

Given the potential outcome of the current examinations as well as the impact of the current examinations on the potential expiration of the statute of limitations, it is reasonably possible that the balance of unrecognized tax benefits could significantly change within the next twelve months. However, at this time, an estimate of the range of reasonably possible adjustments to the balance of unrecognized tax benefits cannot be made.

## 11. Employee Benefit Plan

The Company maintains a 401(k) savings plan covering substantially all of its employees. Eligible employees may contribute up to 60% of their annual salary through payroll deductions, but not more than the statutory limits set by the Internal Revenue Service. The Company matches employee contributions at the discretion of the Board. During 2014, 2013 and 2012, the Company’s matching contributions totaled $8.3 million, $6.5 million and $5.2 million, respectively.

## 12. Segment Information

Beginning in the fourth quarter of 2011, the Company has three reportable segments: Domestic streaming, International streaming and Domestic DVD. Segment information is presented along the same lines that the Company's chief operating decision maker reviews the operating results in assessing performance and allocating resources. The Company's chief operating decision maker reviews revenue and contribution profit for each of the reportable segments. Contribution profit (loss) is defined as revenues less cost of revenues and marketing expenses directly incurred by the segment. The Company has aggregated the results of the International operating segments into one reportable segment because these operating segments share similar long term economic and other qualitative characteristics.

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The Domestic and International streaming segments derive revenues from monthly membership fees for services consisting solely of streaming content. The Domestic DVD segment derives revenues from monthly membership fees for services consisting solely of DVD-by-mail. Revenues and the related payment card fees are attributed to the operating segment based on the nature of the underlying membership (streaming or DVD) and the geographic region from which the membership originates. There are no internal revenue transactions between the Company’s segments. Cost of revenues are primarily attributed to the operating segment based on the amounts directly incurred by the segment to obtain content and deliver it to the specific region. Marketing expenses are primarily comprised of advertising expenses which are generally included in the segment in which the expenditures are directly incurred.
The Company's long-lived tangible assets were located as follows:

| | As of December 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| United States | $138,704 | $126,455 |
| International | 11,171 | 7,150 |

The following tables represent segment information for the year ended December 31, 2014:

| | As of/Year ended December 31, 2014 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total members at end of period (1) | 39,114 | 18,277 | 5,767 | — |
| Revenues | $3,431,434 | $1,308,061 | $765,161 | $5,504,656 |
| Cost of revenues | 2,201,761 | 1,154,117 | 396,882 | 3,752,760 |
| Marketing | 293,453 | 313,733 | — | 607,186 |
| Contribution profit (loss) | $936,220 | $(159,789) | $368,279 | $1,144,710 |
| Other operating expenses | | | | 742,062 |
| Operating income | | | | 402,648 |
| Other income (expense) | | | | (53,279) |
| Provision for income taxes | | | | 82,570 |
| Net income | | | | $266,799 |

| | As of/Year ended December 31, 2014 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total content library, net | $3,476,226 | $1,392,701 | $30,101 | $4,899,028 |
| Amortization of content library | 1,657,673 | 998,606 | 71,491 | 2,727,770 |

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The following tables represent segment information for the year ended December 31, 2013:

| | As of/Year ended December 31, 2013 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total members at end of period (1) | 33,420 | 10,930 | 6,930 | — |
| Revenues | $2,751,375 | $712,390 | $910,797 | $4,374,562 |
| Cost of revenues | 1,863,376 | 782,304 | 471,523 | 3,117,203 |
| Marketing | 265,232 | 204,418 | 292 | 469,942 |
| Contribution profit (loss) | $622,767 | $(274,332) | $438,982 | $787,417 |
| Other operating expenses | | | | 559,070 |
| Operating income | | | | 228,347 |
| Other income (expense) | | | | (57,273) |
| Provision for income taxes | | | | 58,671 |
| Net income | | | | $112,403 |

| | As of/Year ended December 31, 2013 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total content library, net | $2,973,023 | $804,690 | $19,779 | $3,797,492 |
| Amortization of content library | 1,420,076 | 701,905 | 71,325 | 2,193,306 |

The following tables represent segment information for the year ended December 31, 2012:

| | As of/Year ended December 31, 2012 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total members at end of period (1) | 27,146 | 6,121 | 8,224 | — |
| Revenues | $2,184,868 | $287,542 | $1,136,872 | $3,609,282 |
| Cost of revenues | 1,570,600 | 483,295 | 598,163 | 2,652,058 |
| Marketing | 245,259 | 193,390 | 559 | 439,208 |
| Contribution profit (loss) | $369,009 | $(389,143) | $538,150 | $518,016 |
| Other operating expenses | | | | 468,024 |
| Operating income | | | | 49,992 |
| Other income (expense) | | | | (19,512) |
| Provision for income taxes | | | | 13,328 |
| Net income | | | | $17,152 |

| | As of/Year ended December 31, 2012 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total content library, net | $2,317,070 | $527,235 | $29,865 | $2,874,170 |
| Amortization of content library | 1,152,446 | 438,772 | 65,396 | 1,656,614 |

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

13. Selected Quarterly Financial Data (Unaudited)

| | December 31 | September 30 | June 30 | March 31 |
|---|---|---|---|---|
| | (in thousands, except for per share data) | | | |
| 2014 | | | | |
| Total revenues | $1,484,728 | $1,409,432 | $1,340,407 | $1,270,089 |
| Gross profit | 470,396 | 455,038 | 425,559 | 400,903 |
| Net income | 83,371 | 59,295 | 71,018 | 53,115 |
| Earnings per share: | | | | |
| Basic | $1.38 | $0.99 | $1.18 | $0.89 |
| Diluted | 1.35 | 0.96 | 1.15 | 0.86 |
| 2013 | | | | |
| Total revenues | $1,175,230 | $1,105,999 | $1,069,372 | $1,023,961 |
| Gross profit | 354,553 | 307,099 | 308,698 | 287,009 |
| Net income (loss) | 48,421 | 31,822 | 29,471 | 2,689 |
| Earnings (loss) per share: | | | | |
| Basic | $0.81 | $0.54 | $0.51 | $0.05 |
| Diluted | 0.79 | 0.52 | 0.49 | 0.05 |

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: January 29, 2015 | By: | /S/ REED HASTINGS<br>Reed Hastings<br>Chief Executive Officer<br>(principal executive officer) |
| Dated: January 29, 2015 | By: | /S/ DAVID WELLS<br>David Wells<br>Chief Financial Officer<br>(principal financial and accounting officer) |

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POWER OF ATTORNEY

KNOWN ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Reed Hastings and David Wells, and each of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place, and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming that all said attorneys-in-fact and agents, or any of them or their or his substitute or substituted, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, this Annual Report on Form 10-K has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
| --- | --- | --- |
| /S/ REED HASTINGS<br>Reed Hastings | President, Chief Executive Officer and Director (principal executive officer) | January 29, 2015 |
| /S/ DAVID WELLS<br>David Wells | Chief Financial Officer (principal financial and accounting officer) | January 29, 2015 |
| /S/ RICHARD BARTON<br>Richard Barton | Director | January 29, 2015 |
| /S/ TIMOTHY M. HALEY<br>Timothy M. Haley | Director | January 29, 2015 |
| /S/ JAY C. HOAG<br>Jay C. Hoag | Director | January 29, 2015 |
| /S/ ANN MATHER<br>Ann Mather | Director | January 29, 2015 |
| /S/ A. GEORGE BATTLE<br>A. George Battle | Director | January 29, 2015 |
| /S/ LESLIE J. KILGORE<br>Leslie J. Kilgore | Director | January 29, 2015 |

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EXHIBIT INDEX

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | | Filed Herewith |
|---|---|---|---|---|---|---|
| | | Form | File No. | Exhibit | Filing Date | |
| 3.1 | Amended and Restated Certificate of Incorporation | 10-Q | 000-49802 | 3.1 | August 2, 2004 | |
| 3.2 | Amended and Restated Bylaws | 8-K | 000-49802 | 3.1 | March 20, 2009 | |
| 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 | |
| 4.2 | Indenture, dated as of February 1, 2013, by and between the Company and Wells Fargo Bank, National Association, as Trustee. | 8-K | 001-35727 | 4.1 | February 1, 2013 | |
| 4.3 | Indenture, dated as of February 19, 2014, by and between the Company and Wells Fargo Bank, National Association, as Trustee. | 8-K | 001-35727 | 4.1 | February 19, 2014 | |
| 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† | Amended and Restated 2002 Stock Plan | Def 14A | 000-49802 | A | March 31, 2006 | |
| 10.3† | 2011 Stock Plan | Def 14A | 000-49802 | A | April 20, 2011 | |
| 10.4† | Amended and Restated Executive Severance and Retention Incentive Plan | 10-K | 000-49802 | 10.7 | February 1, 2013 | |
| 10.5† | Registration Rights Agreement, dated as of February 19, 2014, by and among the Company and Morgan Stanley & Co. LLC, as representative of the Initial Purchasers listed in Schedule 1 thereto | 8-K | 001-35727 | 10.1 | February 19, 2014 | |
| 10.6† | Performance Bonus Plan | Def 14A | 001-35727 | A | April 28, 2014 | |
| 21.1 | List of Significant Subsidiaries | | | | | X |
| 23.1 | Consent of Ernst & Young LLP | | | | | X |
| 24 | Power of Attorney (see signature page) | | | | | |
| 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 |
| 101 | The following financial information from Netflix, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on January 29, 2015, formatted in XBRL includes: (i) Consolidated Statements of Operations for the Years Ended December 31, 2014, 2013 | | | | | X |

and 2012, (ii) Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2014, 2013 and 2012, (iii) Consolidated Statements of Cash Flows for the Years Ended December 31, 2014, 2013 and 2012, (iv) Consolidated Balance Sheets as of December 31, 2014 and 2013, (v) Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2014, 2013 and 2012 and (vi) the Notes to Consolidated Financial Statements.

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* 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.
† Indicates a management contract or compensatory plan