

NETFLIX INC  
Form 424B2  
May 01, 2006  
Table of Contents

Filed pursuant to Rule 424(b)(2)  
Registration No. 333-133620

PROSPECTUS

## 3,500,000 Shares

### Common Stock

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Netflix, Inc. is offering 3,500,000 shares of common stock. Our common stock is traded on The NASDAQ National Market under the symbol NFLX. On April 27, 2006, the last reported sale price was \$31.29 per share.

*Investing in our common stock involves risk. See Risk Factors beginning on page 6.*

	Per Share	Total
Public offering price	\$ 30.00	\$ 105,000,000
Underwriting discounts and commissions	\$ 1.125	\$ 3,937,500
Proceeds to Netflix, Inc. (before expenses)	\$ 28.875	\$ 101,062,500

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

Lehman Brothers expects to deliver the shares on or about May 3, 2006.

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**LEHMAN BROTHERS**

April 28, 2006

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You should rely only on the information contained or incorporated by reference in this prospectus. Neither we nor the underwriters have authorized anyone to provide you with information that is different from that contained or incorporated by reference in this prospectus. This prospectus is not an offer to sell or a solicitation of an offer to buy shares in any jurisdiction where such offer or any sale of shares would be unlawful. The information in this prospectus is complete and accurate only as of the date on the front cover regardless of the time of delivery of this prospectus or of any sale of shares.

Information contained on our website does not constitute part of this prospectus.

In this prospectus, Netflix, the company, we, us, our, or similar words refer to Netflix, Inc.

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### **SUMMARY**

*This summary highlights information contained elsewhere in this prospectus and the documents incorporated by reference. This summary does not contain all of the information that you should consider before deciding to invest in our common stock. You should read this entire prospectus and the documents incorporated by reference carefully including the Risk Factors on page 6 of this prospectus and our consolidated financial statements and the related notes and other documents incorporated by reference.*

#### **Overview**

We are the largest online movie rental subscription service providing more than 4,866,000 subscribers access to a comprehensive library of more than 60,000 movie, television and other filmed entertainment titles. Our most popular subscription plan allows subscribers to have up to three titles out at the same time with no due dates, late fees or shipping charges for \$17.99 per month. In addition, we offer a number of other subscription plans to accommodate a variety of movie watching preferences. Subscribers select titles at our Web site aided by our proprietary recommendation service, receive them on DVD by U.S. mail and return them to us at their convenience using our prepaid mailers. After a title has been returned, we mail the next available title in a subscriber's queue.

Our subscription service has grown rapidly since its launch in late 1999. This growth has been fueled by the rapid adoption of DVDs as a medium for home entertainment as well as increased awareness of online DVD rentals. We also believe our growth has been driven by our comprehensive selection of titles, consistently high levels of customer satisfaction and our effective marketing programs. We expect that our business will continue to grow as the market for online DVD rentals continues to grow, a reflection of both the convenience and value of the subscription rental model.

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

We continually invest in improvements to our service in an effort to deepen our subscriber relationships as well as to further distinguish our service from that of our competitors. We focus on improving our website experience and functionality and seek to create value-added features for our subscribers, such as our social networking feature, called Friends<sup>SM</sup> and our queue management feature, called Profiles<sup>SM</sup>. In addition, we continue to focus on the new revenue initiatives launched in the second quarter of 2005: retail sales of previously-viewed DVDs and our Ad Sales program. We also continue to invest resources to develop solutions for downloading movies to consumers. Our core strategy has been and remains to grow a large DVD subscription business; however, as technology and infrastructure develop to allow effective and convenient delivery of movies over the Internet and when meaningful content becomes available, we intend to offer our subscribers the choice of receiving their movies on DVD or by downloading, whichever they prefer.

We promote our service to consumers through various marketing programs, including online promotions, television and radio advertising, package inserts, direct mail and other promotions with third parties. These programs encourage consumers to subscribe to our service and may include a free trial period of 14 days. At the end of the free trial period, subscribers are automatically enrolled as paying subscribers, unless they cancel their subscription. All paying subscribers are billed monthly in advance.

We stock more than 60,000 DVD titles. We have established revenue sharing relationships with several studios and distributors. We also purchase titles directly from studios, distributors and independent producers.

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

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

## **Industry Background**

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

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

First, despite the large number of available titles, consumers lack a deep selection of titles from existing subscription channels and traditional video rental outlets. Subscription channels, such as HBO and Showtime, and pay-per-view services continue to offer a narrow selection of titles at specified times due to programming schedule constraints and technological issues relating to channel capacity. Traditional video rental outlets primarily offer new releases and devote limited space to display and stock back catalogue titles. We believe our selection of over 60,000 titles offers an attractive alternative to these traditional channels.

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

## **Competitive Strengths**

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

*Comprehensive Library of Titles.* We have developed strategic relationships with top studios and distributors, enabling us to establish and maintain a broad and deep selection of titles. Since our service is available nationally, we believe that we can economically acquire and provide subscribers a broader selection of titles than video rental outlets, video retailers, subscription channels, pay-per-view and VOD services. To maximize our selection of titles, we continuously add newly released titles to our library. Our library contains numerous copies of popular new releases, as well as many titles that appeal to more select audiences. We currently offer more than 60,000 titles.

*Personalized Merchandizing.* We utilize our proprietary recommendation service to create a custom interface for each subscriber to effectively merchandize our library. Subscribers rate titles on our Web

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site, and our recommendation service compares these ratings to the database of ratings collected from our entire user base. For each visitor, these comparisons are used to make predictions about specific titles the visitor may enjoy. These predictions are used to merchandize titles to visitors throughout the Web site. As of March 31, 2006, we had approximately one billion movie ratings in our database. We believe that our recommendation service allows us to create demand for our entire library and maximize utilization of each title.

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

*Convenience, Selection and Fast Delivery.* Subscribers can conveniently select titles by building and modifying a personalized queue of titles on our Web site. We create a unique experience for subscribers because most pages on our Web site are tailored to individual selection and ratings history. Under our most popular service, subscribers can have up to three DVDs out at the same time with no due dates or late fees. Based on their queue, we send them available DVDs by U.S. mail that are then returned to us in prepaid mailers. After receipt of returned DVDs, we mail subscribers the next available title in their queue of selected titles. Our nationwide network of distribution centers allows us to offer fast delivery.

### **Growth Strategy**

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

*Providing Compelling Value for Subscribers.* We provide subscribers access to our comprehensive library of more than 60,000 titles with no due dates, late fees or shipping charges for a fixed monthly fee. We merchandize titles in easy-to-recognize lists including new releases, by genre and other targeted categories. Our convenient, easy-to-use Web site allows subscribers to quickly select current titles, reserve upcoming releases and build an individual queue for future viewing using our proprietary personalization technology. We provide service features to our subscribers that, among other things, enable social networking and further individualization of the service through establishment of sub-account queues and recommendations. Our recommendation service provides subscribers with recommendations of titles from our library. We quickly deliver titles to subscribers from our shipping centers located throughout the United States by U.S. mail.

*Utilizing Technology to Enhance Subscriber Experience and Operate Efficiently.* We utilize proprietary technology developed internally to manage the processing and distribution of DVDs from our shipping centers. Our software automates the process of tracking and routing titles to and from each of our shipping centers and allocates order responsibilities among them. We continuously monitor, test and seek to improve the efficiency of our distribution, processing and inventory management systems as our subscriber base and shipping volume grows. We operate a nationwide network of shipping centers. We anticipate opening additional shipping centers in 2006.

*Building Mutually Beneficial Relationships with Filmed Entertainment Providers.* We have invested substantial resources in establishing strong ties with various filmed entertainment providers. We

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maintain an office in Los Angeles that provides us access to the major studios. We have entered into a number of revenue sharing agreements with studios and we also purchase titles directly. We work with the content providers to determine which method of acquiring titles is the most beneficial for each party. Our growing subscriber base provides studios with an additional distribution outlet for popular movies and television series, as well as niche titles and programs.

### **Our Web site [www.netflix.com](http://www.netflix.com)**

We have applied substantial resources to plan, develop and maintain proprietary technology to implement the features of our Web site, such as subscription account sign up and management, personalized movie merchandising, inventory optimization and customer support. We also launched new features such as our social networking feature, called Friends<sup>SM</sup> and our queue management feature, called Profiles<sup>SM</sup>. Our software is written in a variety of languages and runs on industry standard platforms.

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

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

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

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

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

### **Corporate 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](http://www.netflix.com). The contents of our Web site are not incorporated in, or otherwise to be regarded as part of, this prospectus.

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

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**The Offering**

<b>Common stock offered</b>	3,500,000 shares
<b>Common stock to be outstanding after this offering</b>	59,010,338 shares
<b>Use of proceeds</b>	We will receive net proceeds from this offering of approximately \$101 million. See Use of Proceeds. We intend to use the net proceeds from this offering for general corporate purposes, including working capital, and potentially for acquisitions of complementary businesses, technologies or other assets.
<b>NASDAQ National Market Symbol</b>	NFLX
<b>Risk Factors</b>	Investing in our common stock involves risk. See Risk Factors beginning on page 6.

The number of shares of our common stock outstanding after this offering is based on the number of shares outstanding as of March 31, 2006, and excludes:

5,584,504 shares of common stock issuable upon the exercise of options outstanding at March 31, 2006, at a weighted average exercise price of \$11.46 per share;

8,824,700 shares of common stock issuable upon the exercise of warrants outstanding at March 31, 2006, at a weighted average exercise price of \$1.50 per share; and

6,356,102 shares of common stock available under our 2002 Stock Plan at March 31, 2006 reserved for future awards.

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**RISK FACTORS**

*Before you invest in our common stock, you should carefully consider the following risks, in addition to the other information contained and incorporated by reference in this prospectus. If any of the following risks actually occurs, our business, financial condition and results of operations could be harmed. In that case, the trading price of our common stock could decline, and you could lose all or part of your investment.*

**Risks Related to Our Business**

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

We must continue to attract new subscribers. To succeed, we must continue to attract a large number of subscribers who have traditionally used video retailers, video rental outlets, cable channels, such as HBO and Showtime, pay-per-view and VOD for in-home filmed entertainment. In addition, we face direct competition to our service, namely from services like Blockbuster Online, that will likely impact our ability to attract subscribers. Our ability to attract subscribers will depend in part on our ability to consistently provide our subscribers with a valuable and quality experience for selecting, viewing, receiving and returning titles, including providing accurate recommendations through our recommendation service. Furthermore, if our competitors are able to offer similar service levels at lower prices, our ability to attract subscribers will be affected adversely. If consumers do not perceive our service offering to be of value, or if we introduce new services that are not favorably received by them, we may not be able to attract subscribers. In addition, many of our new subscribers originate from word-of-mouth advertising and referrals from existing subscribers. If our efforts to satisfy our existing subscribers are not successful, we may not be able to attract new subscribers, and as a result, our revenues will be affected adversely.

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

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

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

The market for in-home filmed entertainment is intensely competitive and subject to rapid change. New technologies for delivery of in-home filmed entertainment, such as VOD and downloading over the Internet, continue to receive considerable media attention. Many of our competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. The rapid growth of our online entertainment subscription business since our inception may continue to attract direct competition from larger companies with significantly greater financial resources and national brand recognition. For example, we have seen the entry of direct competition from Blockbuster, which launched its online service in August 2004, and could face competition from potential new entrants into the online DVD rental market. 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.

In addition, many consumers maintain simultaneous relationships with multiple in-home filmed entertainment providers and can easily shift spending from one provider to another. For example, consumers may



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subscribe to HBO, rent a DVD from Blockbuster, buy a DVD from Wal-Mart and subscribe to Netflix, or some combination thereof, all in the same month. New competitors may be able to launch new businesses at relatively low cost. DVDs represent only one of many existing and potential new technologies for viewing filmed entertainment. In addition, the growth in adoption of DVD technology is not mutually exclusive from the growth of other technologies. If we are unable to successfully compete with current and new competitors and technologies, we may not be able to achieve adequate market share, increase our revenues or maintain profitability. Our principal competitors include, or could include:

video rental outlets, such as Blockbuster and Movie Gallery;

online DVD subscription rental sites, such as Blockbuster Online;

pay-per-view and VOD services and alternative content delivery methods such as Apple's video iPod and MovieBeam;

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

subscription entertainment services, such as HBO and Showtime;

Internet movie providers, such as Movielink, CinemaNow.com and Vongo;

Internet companies such as Yahoo! and Google;

cable providers, such as Time Warner and Comcast; and

direct broadcast satellite providers, such as DIRECTV and Echostar.

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

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

Some digital cable providers and Internet content providers have implemented technology referred to as VOD. This technology transmits movies and other entertainment content on demand with interactive capabilities such as start, stop and rewind. High-speed Internet access has greatly increased the speed and quality of viewing VOD content, including feature-length movies, on personal computers over the Internet. In addition, other technologies have been developed that allow alternative means for consumers to receive and watch movies or other entertainment, such as on cell phones or other handheld devices such as Apple's iPod. If VOD or other technologies become affordable and viable alternative methods of content delivery widely supported by studios and adopted by consumers, our business could be adversely affected.

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

Consumers have rapidly adopted the DVD format for viewing in-home filmed entertainment. Over the past several years DVD sales have grown and now surpassed the VHS format. In addition, DVD sales account for more than 42% of studio revenues. We believe that the DVD format,

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including any successor formats such as HD-DVD and BluRay, will be valuable long-term consumer propositions and studio profit centers. However, if DVD sales were to decrease, whether because of a shift away from movie watching or because new or existing technologies were to become more popular at the expense of DVD enjoyment, studios and retailers may reduce their support of the DVD format. Our subscriber growth will be substantially influenced by future popularity of the DVD format, and if such popularity wanes, our subscriber growth may also slow.

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

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

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

the length of this window was shortened.

The order, length and exclusivity of each window for each distribution channel is determined solely by the studio releasing the title, and we cannot assure you that the studios will not change their policies in the future in a manner that would be adverse to our business and results of operations. Currently, studios distribute their filmed entertainment content approximately three to six months after theatrical release to the home video market, seven to nine months after theatrical release to pay-per-view and VOD, one year after theatrical release to satellite and cable, and two to three years after theatrical release to basic cable and syndicated networks. However, in what continues to be an emerging trend, the major studios have shortened the release window on certain titles, in particular the theatrical to home video window. In addition, some studios have discussed eliminating the release window on certain titles, in particular releasing movies simultaneously on DVD and VOD.

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

With our unlimited plans, there is no established limit to the number of movies that subscribers may rent. Historically, on a plan-by-plan basis, we have seen the average number of movies rented per subscriber increase on an annual basis. We believe that this increase in usage is influenced by improvements to our service as well as consumer usage habits. In addition, demand for titles may increase for a variety of reasons beyond our control, including promotion by studios and seasonal variations or shifts in consumer movie watching.

We are continually adjusting our service in ways that may impact subscriber movie usage. Such adjustments include new Web site features and merchandising practices, an expanded distribution network, as well as software and process changes.

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

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

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

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

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

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

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

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

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

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

We have expanded rapidly since we launched our Web site in April 1998. We anticipate further expanding our operations to help grow our subscriber base and to take advantage of favorable market opportunities. Any future expansion will likely place significant demands on our managerial, operational, administrative and financial resources. If we are not able to respond effectively to new or increased demands that arise because of our growth, or, if in responding, our management is materially distracted from our current operations, our business may be affected adversely. In addition, if we do not have sufficient breadth and depth of the titles necessary to satisfy increased demand arising from growth in our subscriber base, our subscriber satisfaction may be affected adversely.

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

We use complex proprietary software to process deliveries and returns of our DVDs and to manage other aspects of our operations. Our proprietary technology is intended to allow our nationwide network of shipping centers to be operated on an integrated basis. We continually enhance or modify the software used for our distribution operations. We cannot be sure that any enhancements or other modifications we make to our distribution operations will achieve the intended results or otherwise be of value to our subscribers. Future enhancements and modifications to our proprietary technology could consume considerable resources. If we are unable to maintain and enhance our technology to manage the processing of DVDs among our shipping centers in a timely and efficient manner, our ability to retain existing subscribers and to add new subscribers may be impaired.

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

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

**Increases in the cost of delivering DVDs could adversely affect our gross profit and marketing expenses.**

Increases in postage delivery rates will adversely affect our gross profit if we elect not to raise our subscription fees to offset the increase. The U.S. Postal Service recently increased the rate for first class postage on January 8, 2006 by 2 cents, from 37 cents to 39 cents. In addition, the U.S. Congress has been considering postal reform legislation which would provide the U.S. Postal Service with more flexibility in establishing postal rates. The U.S. Postal Service continues to focus on plans to reduce its costs and make its service more efficient. If the U.S. Postal Service were to change any policies relative to the requirements of first-class mail, including changes in size, weight or machinability qualifications of our DVD envelopes, such changes could result in increased shipping costs or higher breakage for our DVDs and our gross margin could be affected adversely. Also, if the U.S. Postal Service curtails its services, such as by closing facilities or discontinuing or reducing Saturday delivery service, our ability to timely deliver DVDs could diminish, and our subscriber satisfaction could be affected adversely.

Currently, most filmed entertainment is packaged on a single lightweight DVD. Our delivery process is designed to accommodate the delivery of one DVD to fulfill a selection. Because of the lightweight nature of a DVD, we generally mail one envelope containing a title using standard U.S. postage. Studios occasionally provide additional content on a second DVD or may package a title on two DVDs. In addition, the studios have recently announced plans to release certain films in high definition format on HD-DVDs and BluRay DVDs. These new DVDs have characteristics that are different than those currently in circulation. These high-definition format DVDs may be heavier and/or more fragile than current DVDs. If packaging of filmed entertainment on multiple DVDs were to become more prevalent, if the weight of DVDs were to increase, or the durability of DVDs deteriorate, our costs of delivery and fulfillment processing would increase and our costs of replacing damaged DVDs may rise materially which would depress gross margins and profitability and adversely affect free cash flow.

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

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

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

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

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

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

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

### **If we do not correctly anticipate our short- and long-term needs for titles, our subscriber satisfaction and results of operations may be affected adversely.**

If we do not acquire sufficient copies of titles, we may not satisfy subscriber demand, and our subscriber satisfaction and results of operations could be affected adversely. Conversely, if we attempt to mitigate this risk and acquire more copies than needed to satisfy our subscriber demand, our inventory utilization would become less effective and our gross margins would be affected adversely.

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

Since 2000, we have entered into numerous revenue sharing arrangements with studios and distributors. These revenue sharing agreements generally have terms of up to five years. Revenue share agreements typically enable us to increase our copy depth of DVDs on an economical basis because of the low initial payment. Additional payments are made only if our subscribers rent the DVD. Under a purchase arrangement, we must pay the full wholesale price, regardless of whether the DVD is rented. In addition, revenue sharing agreements generally provide for studio promotional support of the associated DVD and our service as well as permit us to own the DVD following expiration of the revenue sharing period, typically no more than 12 months following the date the title is publicly released on DVD.

During the course of our revenue sharing relationship with studios and distributors, various contract administration issues arise. To the extent that we are unable to resolve any of these issues in an amicable manner, our relationship with the studios and distributors may be adversely impacted.

As our revenue sharing agreements expire, we may be required to negotiate new terms that could be disadvantageous to us or if we cannot renew the agreements we would be required to purchase titles. In such event, the cost of acquiring content could increase and our gross margins may be affected adversely. In addition, if we were required to purchase titles the risk associated with accurately predicting title demand could increase.

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Titles that we do not acquire under a revenue sharing agreement are purchased on a wholesale basis from studios or other distributors. If the price of purchased titles increases, our gross margin will be affected adversely.

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

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

### **We may need additional capital, and we cannot be sure that additional financing will be available.**

Our need and ability to obtain financing will depend, among other things, on our development efforts, business plans, operating performance and condition of the capital markets at the time we seek financing. We cannot assure you that additional financing will be available to us on favorable terms when required, or at all. If we raise additional funds through the issuance of equity, equity-linked or debt securities, those securities may have rights, preferences or privileges senior to the rights of our common stock, and our stockholders may experience dilution.

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

Subscribers and potential subscribers access our service through our Web site, where the title selection process is integrated with our delivery processing systems and software. Our reputation and ability to attract, retain and serve our subscribers is dependent upon the reliable performance of our Web site, network infrastructure and fulfillment processes. Interruptions in these systems could make our Web site unavailable and hinder our ability to fulfill selections. Much of our software is proprietary, and we rely on the expertise of our engineering and software development teams for the continued performance of our software and computer systems. Service interruptions or the unavailability of our Web site could diminish the overall attractiveness of our subscription service to existing and potential subscribers.

Our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions and delays in our service and operations as well as loss, misuse or theft of data. Our Web site periodically experiences directed attacks intended to cause a disruption in service. Any attempts by hackers to disrupt our Web site service or our internal systems, if successful, could harm our business, be expensive to remedy and damage our reputation. Our insurance does not cover expenses related to direct attacks on our Web site or internal systems. Efforts to prevent hackers from entering our computer systems are expensive to implement and may limit the functionality of our services. Any significant disruption to our Web site or internal computer systems could result in a loss of subscribers and adversely affect our business and results of operations.

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

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

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

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

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

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

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

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

To secure transmission of confidential information obtained by us for billing purposes, including subscribers' credit card or checking account data, we rely on licensed encryption and authentication technology. In conjunction with the payment processing companies, we take measures to protect against unauthorized intrusion into our subscribers' data. If, despite these measures, we experience any unauthorized intrusion into our subscribers' data, current and potential subscribers may become unwilling to provide the information to us necessary for them to become subscribers, and our business could be affected adversely. Similarly, if a well-publicized breach of the consumer data security of any other major consumer Web site were to occur, there could be a general public loss of confidence in the use of the Internet for commerce transactions, which could adversely affect our business.

In addition, because we obtain subscribers' billing information on our Web site, we do not obtain signatures from subscribers in connection with the use of credit cards by them. Under current credit card practices, to the extent we do not obtain cardholders' signatures, we are liable for fraudulent credit card transactions, even when the associated financial institution approves payment of the orders. From time to time, fraudulent credit cards are used on our Web site to obtain service and access our DVD inventory. Typically, these credit cards have not been registered as stolen and are therefore not rejected by our automatic authorization safeguards. While we do have a number of other safeguards in place, we nonetheless experience some loss from these fraudulent transactions. We



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do not currently carry insurance against the risk of fraudulent credit card transactions. A failure to adequately control fraudulent credit card transactions would harm our business and results of operations.

### **Increases in payment processing fees or changes to operating rules would increase our operating expenses and adversely affect our business and results of operations.**

Our subscribers pay for our subscription services predominately using credit cards and debit cards and, to a lesser extent, electronic checks. Our acceptance of these payment methods requires our payment of certain fees. From time to time, these fees may increase, either as a result of rate changes by the payment processing companies or as a result in a change in our business practices which increase the fees on a cost-per-transaction basis. These fees may increase in 2006. Such increase may adversely affect our results of operations. We are also subject to rules, regulations and practices governing our accepted payment methods, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept these payment methods, and our business and results of operations would be adversely affected.

### **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; for example, we filed a complaint for patent infringement against Blockbuster, Inc., on April 4, 2006. Netflix is a registered trademark of Netflix, Inc. in the United States and United Kingdom. We have also filed trademark applications in the United States for the Friends and Profiles service marks and for the Netflix design logo, and have filed U.S. patent applications for certain aspects of our technology. We have also filed a trademark application in the European Union for the Netflix name. From time to time we expect to file additional trademark and patent applications. Nevertheless, these applications may not be approved, third parties may challenge any patents issued to or held by us, third parties may knowingly or unknowingly infringe our patents, trademarks and other proprietary rights, and we may not be able to prevent infringement without substantial expense to us. If the protection of our proprietary rights is inadequate to prevent use or appropriation 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 subscribers and potential subscribers may become confused in the marketplace and our ability to attract subscribers may be adversely affected.

### **Intellectual property claims against us could be costly and result in the loss of significant rights related to, among other things, our Web site, our recommendation service, 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 or develop non-infringing intellectual property 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 affected adversely. 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 exhaustively 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

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management personnel. It also may result in our inability to use our current Web site or our recommendation service 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 merchandizing 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.

**If we are unable to protect our domain names, our reputation and brand could be affected adversely.**

We currently hold various domain names relating to our brand, including Netflix.com. Failure to protect our domain names could affect adversely our reputation and brand, and make it more difficult for users to find our Web site and our service. The acquisition and maintenance of domain names generally are regulated by governmental agencies and their designees. The regulation of domain names in the United States may change in the near future. Governing bodies may establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names. Furthermore, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. 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.

**Forecasting film revenue and associated gross profits from our films prior to release is extremely difficult and may result in significant write-offs.**

We are required to amortize capitalized film production costs over the expected revenue streams as we recognize revenue from the associated films. The amount of film production costs that will be amortized each period depends on how much future revenue we expect to receive from each film. Unamortized film production costs are evaluated for impairment each reporting period on a film-by-film basis. If estimated remaining revenue is not sufficient to recover the unamortized film production costs, the unamortized film production costs will be written down to fair value. In any given period, if we lower our previous forecast with respect to total anticipated revenue from any individual film, we would be required to accelerate amortization of related film costs. Such accelerated amortization would adversely impact our business, operating results and financial condition. In addition, we base our estimates of revenue on performance of comparable titles and our knowledge of the industry. If the information is incorrect, the amount of revenue and related expenses that we recognize from our films could be wrong, which could result in fluctuations in our earnings.

**If we become subject to liability for content that we publish or that we distribute on DVD through our service, our results of operations would be affected adversely.**

As a publisher of content, a host of third party content and a distributor of content on DVD, we face potential liability for negligence, copyright, patent or trademark infringement or other claims based on the nature and content of materials that we publish or distribute. We also may face potential liability for content uploaded from our users in connection with our community-related content or movie reviews.

If we become liable, then our business may suffer. Litigation to defend these claims could be costly and the expenses and damages arising from any liability could harm our results of operations. We cannot assure you that we are adequately insured to cover claims of these types or to indemnify us for all liability that may be imposed on us.

**If government regulation of the Internet or other areas of our business changes or if consumer attitudes toward use of the Internet change, we may need to change 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

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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.

The manner in which Internet and other legislation may be interpreted and enforced cannot be precisely determined and may subject either us or our customers to potential liability, which in turn could have an adverse effect on our business, results of operations and financial condition. The adoption of any laws or regulations that adversely affect the popularity or growth in use of the Internet, including laws limiting Internet neutrality, could decrease the demand for our subscription service and increase our cost of doing business. In addition, if consumer attitudes toward use of the Internet change, consumers may become unwilling to select their entertainment online or otherwise provide us with information necessary for them to become subscribers. Further, we may not be able to effectively market our services online to users of the Internet. If we are unable to interact with consumers because of changes in their attitude toward use of the Internet, our subscriber acquisition and retention may be affected adversely.

**We may be 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. Such 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.

**Recently enacted changes in securities laws and regulations have increased and may continue to increase our costs.**

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and recently-enacted rules promulgated by the SEC, have increased and may continue to increase our expenses as we evaluate the implications of these rules and devote resources to respond to their requirements.

The NASDAQ National Market, on which our common stock is listed, has also adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices. We also expect these developments to make it more difficult and more expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, our board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which would adversely affect our business.

**We record substantial expenses related to our issuance of stock options that may have a material negative impact on our operating results for the foreseeable future.**

During the second quarter of 2003, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 *Accounting for Stock-Based Compensation* ( SFAS 123 ) for stock-based employee compensation. In addition, during the third quarter of 2003, we began granting stock options to our employees on a monthly basis. The vesting periods provide for options to vest immediately, in comparison with the three to four-year vesting periods for stock options granted prior to the third quarter of 2003. As a result of immediate vesting, stock-based compensation expenses determined under SFAS No. 123 are fully recognized in the same periods as the monthly stock option grants. In addition, we continue to amortize the deferred

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compensation of stock options with three to four-year vesting periods granted prior to the third quarter of 2003 over the remaining vesting periods. Our stock-based compensation expenses totaled \$10.7 million, \$16.6 million and \$14.3 million during 2003, 2004 and 2005, respectively. We expect our stock-based compensation expenses will continue to be significant in future periods, which will have an adverse impact on our operating results. The Black-Scholes option-pricing model, used by us, requires the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. Changes in the subjective input assumptions can materially affect the fair value estimate.

### **Risks Related to This Offering**

#### **We may apply the proceeds of this offering to uses that do not improve our operating results or increase the value of your investment.**

We anticipate that we will use the net proceeds from this offering for general corporate purposes, including working capital and capital expenditures. In addition, we may use proceeds of this offering for acquisitions of businesses, technologies or other assets that we believe will complement our business. Pending such uses, we may be limited in the types of investments we can make with the proceeds pursuant to the Investment Company Act of 1940. As a result of the foregoing, these proceeds could be applied in ways that do not improve our operating results or increase the value of your investment.

#### **Our officers and directors and their affiliates will exercise significant control over Netflix.**

As of March 31, 2006, our executive officers and directors, their immediate family members and affiliated venture capital funds beneficially owned, in the aggregate, approximately 27.65 percent of our outstanding common stock, warrants and stock options that are exercisable within 60 days. In particular, Jay Hoag, one of our directors, beneficially owned approximately 17.47 percent and Reed Hastings, our Chief Executive Officer, President and Chairman of the Board, beneficially owned approximately 9.46 percent. These stockholders may have individual interests that are different from yours and will be able to exercise significant control over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, which could delay or prevent someone from acquiring or merging with us.

#### **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.

In addition, a merger or acquisition may trigger retention payments to certain executive employees under the terms of our Executive Severance and Retention Incentive Plan, thereby increasing the cost of such a transaction. 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 percent or more of its capital stock unless the holder has 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.



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**Our stock price is volatile.**

The price at which our common stock has traded since our May 2002 initial public offering 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 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 by us and financial analysts who may publish estimates of our performance 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, gross margin, operating expenses, number of paying subscribers, number of DVDs shipped per day 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.

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus and the documents incorporated by reference in this prospectus contain forward-looking statements within the meaning of the federal securities laws. These forward-looking statements include all statements other than statements of historical facts contained in this prospectus, including statements regarding growth of our business and growth of the online DVD rental market; additional shipping centers; developments in content delivery, downloading and the DVD format; our strategies for maintaining our market position as the market for home entertainment develops; and our use of proceeds from this offering. The words believe, may, will, estimate, continue, anticipate, intend, plan, should, potential, predict and similar expressions are intended to identify forward-looking statements. 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 prospectus and particularly Risk Factors starting on page 6 and elsewhere in this prospectus. We caution you not to rely on these statements without also considering the risks and uncertainties associated with these statements and our business that are addressed in this prospectus. All forward-looking statements included in this document are based on information available to us on the date hereof. Although we assume no obligation to revise or publicly release the results of any revision to any such forward-looking statement, except as may otherwise be required by law, you are advised to consult any additional disclosures we make in our quarterly reports on Form 10-Q, annual report on Form 10-K and current reports on Form 8-K filed with the SEC. See Where You Can Find More Information.

**USE OF PROCEEDS**

We will receive net proceeds from this offering of approximately \$101 million, after deducting underwriting discounts and commissions and estimated offering expenses. We intend to use the net proceeds from this offering for general corporate purposes, including working capital. In addition, we may use proceeds from this offering for acquisitions of complementary businesses, technologies or other assets. We have no current agreements or commitments with respect to any material acquisitions. Pending such uses, we plan to invest the net proceeds in highly liquid, investment grade securities.

**Table of Contents****UNDERWRITING**

Under the terms of an underwriting agreement, which we will file by post-effective amendment, Lehman Brothers Inc., as the underwriter in this offering, has agreed to purchase from us, 3,500,000 shares of common stock.

The underwriting agreement provides that the underwriter's obligation to purchase shares of common stock depends on the satisfaction of the conditions contained in the underwriting agreement including:

the obligation to purchase all of the shares of common stock offered hereby, if any of the shares are purchased;

the representations and warranties made by us to the underwriter are true;

there is no material change in our business or in the financial markets; and

we deliver customary closing documents to the underwriter.

**Commissions and Expenses**

The following table summarizes the underwriting discounts and commissions we will pay to the underwriter. The underwriting fee is the difference between the initial price to the public and the amount the underwriter pays to us for the shares.

Per share	\$ 1.125
Total	\$ 3,937,500

The underwriter has advised us that it proposes to offer the shares of common stock directly to the public at the public offering price on the cover of this prospectus and to selected dealers, which may include the underwriter, at such offering price less a selling concession not in excess of \$0.05 per share. After the offering, the underwriter may change the offering price and other selling terms.

The expenses of the offering that are payable by us are estimated to be \$200,000 (excluding underwriting discounts and commissions).

**Lock-Up Agreements**

We and all of our directors and executive officers have agreed that, subject to certain exceptions, without the prior written consent of Lehman Brothers Inc., we and they will not directly or indirectly (1) offer for sale, sell, pledge, or otherwise dispose of (or enter into any transaction or device that is designed to, or could be expected to, result in the disposition by any person at any time in the future of) any shares of common stock (including, without limitation, shares of common stock that may be deemed to be beneficially owned by the undersigned in accordance with the rules and regulations of the Securities and Exchange Commission and shares of common stock that may be issued upon exercise of any options or warrants) or securities convertible into or exercisable or exchangeable for common stock, (2) enter into any swap or other derivatives transaction that transfers to another, in whole or in part, any of the economic consequences of ownership of the common stock, (3) make any demand for or exercise any right or file or cause to be filed a registration statement, including any amendments thereto, with respect to the registration of any shares of common stock or securities convertible, exercisable or exchangeable into common stock or any of our other securities, or (4) publicly disclose the intention to do any of the foregoing for a period of 90 days after the date of this prospectus.

Lehman Brothers Inc., in its sole discretion, may release the common stock and other securities subject to the lock-up agreements described above in whole or in part at any time with or without notice. When determining whether or not to release the common stock and other securities from lock-up agreements, Lehman Brothers Inc.





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will consider, among other factors, the holder's reasons for requesting the release, the number of shares of common stock or other securities for which the release is being requested and market conditions at the time.

### **Indemnification**

We have agreed to indemnify the underwriter against certain liabilities, including liabilities under the Securities Act, and to contribute to payments that the underwriter may be required to make for these liabilities.

### **Stabilization and Short Positions**

The underwriter may engage in stabilizing transactions, covering transactions or purchases for the purpose of pegging, fixing or maintaining the price of the common stock, in accordance with Regulation M under the Exchange Act:

Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.

Covering transactions involve purchases of the common stock in the open market after the distribution has been completed in order to cover short positions.

These stabilizing transactions and covering transactions may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of the common stock. As a result, the price of the common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the Nasdaq National Market or otherwise and, if commenced, may be discontinued at any time.

Neither we nor the underwriter make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the common stock. In addition, neither we nor the underwriter make representation that the underwriter will engage in these stabilizing transactions or that any transaction, once commenced, will not be discontinued without notice.

### **Passive Market Making**

In connection with the offering, underwriters and selling group members may engage in passive market making transactions in the common stock on the NASDAQ National Market in accordance with Rule 103 of Regulation M under the Securities Exchange Act of 1934 during the period before the commencement of offers or sales of common stock and extending through the completion of distribution. A passive market maker must display its bids at a price not in excess of the highest independent bid of the security. However, if all independent bids are lowered below the passive market maker's bid that bid must be lowered when specified purchase limits are exceeded.

### **Electronic Distribution**

A prospectus in electronic format may be made available on the Internet sites or through other online services maintained by the underwriter or by its affiliates. In those cases, prospective investors may view offering terms online and, depending upon the particular underwriter, prospective investors may be allowed to place orders online. The underwriter may agree with us to allocate a specific number of shares for sale to online brokerage account holders. Any such allocation for online distributions will be made by the underwriter on the same basis as other allocations.

Other than the prospectus in electronic format, the information on the underwriter's website and any information contained in any other website maintained by the underwriter is not part of the prospectus or the registration statement of which the prospectus forms a part, has not been approved and/or endorsed by us or the underwriter in its capacity as underwriter and should not be relied upon by investors.

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**Stamp Taxes**

If you purchase shares of common stock offered in the prospectus, you may be required to pay stamp taxes and other charges under the laws and practices of the country of purchase, in addition to the offering price listed on the cover page of the prospectus.

**Relationships**

From time to time, Lehman Brothers Inc. and its affiliates have, directly or indirectly, provided investment and commercial banking or financial advisory services to Netflix, its affiliates, for which they have received customary fees and commissions, and expect to provide these services to us and others in the future, for which they expect to receive customary fees and commissions.

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**LEGAL MATTERS**

The validity of the common stock offered hereby will be passed upon for us by Wilson Sonsini Goodrich & Rosati, Professional Corporation, Palo Alto, California. Lehman Brothers Inc. was represented by Weil, Gotshal & Manges LLP, New York, New York.

**EXPERTS**

Our financial statements as of December 31, 2005 and 2004, and for each of the years in the three-year period ended December 31, 2005, and management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005, have been incorporated by reference herein in reliance upon the reports of KPMG LLP, independent registered public accounting firm, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

The audit report on management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting as of December 31, 2005, expresses the opinion that the Company did not maintain effective internal control over financial reporting as of December 31, 2005 because of the effect of a material weakness on the achievement of the objectives of the control criteria and contains an explanatory paragraph that states the following material weakness, relating to accounting for income taxes, had been identified and included in management's assessment: The Company's policies and procedures do not include adequate management review of the calculations and related supporting documentation to ensure that its accounting for income taxes was in accordance with generally accepted accounting principles.

**INFORMATION INCORPORATED BY REFERENCE**

The SEC allows us to incorporate by reference the information contained in documents that we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus and any prospectus supplement. Information in this prospectus supersedes information incorporated by reference that we filed with the SEC prior to the date of this prospectus, while information that we file later with the SEC will automatically update and supersede this information. The following documents have been filed by the Company with the SEC and are incorporated herein by reference:

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2005;

Our Definitive Proxy Statement on Schedule 14A filed on March 31, 2006;

Our Current Report on Form 8-K filed on January 6, 2006; and

The description of the Registrant's common stock contained in the registration statement on Form 8-A filed on May 6, 2002 and any amendment or report filed for the purpose of updating such description.

All documents subsequently filed by the Registrant pursuant to Sections 13(a), 13(c), 14 and 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), prior to the termination of the offering shall be deemed to be incorporated by reference in this registration statement and to be a part hereof from the date of filing of such documents; except as to any portion of any future annual or quarterly report to stockholders or document that is not deemed filed under such provisions. For the purposes of this prospectus, any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this prospectus.

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You can request a copy of these filings at no cost, by writing or calling us at the following address:

Netflix, Inc.

100 Winchester Circle

Los Gatos, CA 95032

Attention: Corporate Secretary

(408) 540-3700

**WHERE YOU CAN FIND MORE INFORMATION**

We file annual, quarterly and special reports and other information with the Commission. You may read and copy and documents we file at the Commission's Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the public reference room. The SEC also maintains an Internet web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of the site is [www.sec.gov](http://www.sec.gov).

Our Internet address is [www.netflix.com](http://www.netflix.com) and the investor relations section of our website is located at <http://ir.netflix.com>. We make available free of charge, on or through the investor relations section of our website, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Commission.

You should rely only on the information contained or incorporated by reference in this Prospectus and in any accompanying prospectus supplement. We have not authorized anyone to provide you with information different from that contained in this Prospectus. The shares of common stock offered under this Prospectus are offered only in jurisdictions where offers and sales are permitted. The information contained in this Prospectus is accurate only as of the date of this Prospectus, regardless of the time of delivery of this Prospectus or any sale of the common stock.

This Prospectus constitutes a part of a Registration Statement we filed with the Commission under the Securities Act. This Prospectus does not contain all of the information set forth in the Registration Statement, certain parts of which are omitted in accordance with the rules and regulations of the Commission. For further information with respect to Netflix and the shares of common stock, reference is hereby made to the Registration Statement. The Registration Statement may be inspected at the public reference facilities maintained by the Commission at the addresses set forth in the preceding paragraph. Statements contained herein concerning any document filed as an exhibit are not necessarily complete, and, in each instance, reference is made to the copy of such document filed as an exhibit to the Registration Statement. Each such statement is qualified in its entirety by such reference.

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3,500,000 Shares

**Common Stock**

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PROSPECTUS

April 28, 2006

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**LEHMAN BROTHERS**