NETFLIX INC
Form 10-Q
July 18, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
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: 001-35727

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

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

100 Winchester Circle, Los Gatos, California 95032
(Address and zip code of principal executive offices)
(408) 540-3700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer x | Accelerated filer o |
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |
| | Emerging growth company o |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes o No x
As of June 30, 2018, there were 435,457,505 shares of the registrant's common stock, par value $0.001, outstanding.

Table of Contents


| | | Page |
|---|---|---|
| | Part I. Financial Information | |
| Item 1. | Consolidated Financial Statements | |
| | Consolidated Statements of Operations | 3 |
| | Consolidated Statements of Comprehensive Income | 4 |
| | Consolidated Statements of Cash Flows | 5 |
| | Consolidated Balance Sheets | 6 |
| | Notes to Consolidated Financial Statements | 7 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 19 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 33 |
| Item 4. | Controls and Procedures | 33 |
| | Part II. Other Information | |
| Item 1. | Legal Proceedings | 33 |
| Item 1A. | Risk Factors | 34 |
| Item 6. | Exhibits | 34 |
| Signatures | | 35 |
| Exhibit Index | | 36 |

Table of Contents

NETFLIX, INC.
Consolidated Statements of Operations
(unaudited)
(in thousands, except per share data)

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| Revenues | $3,907,270 | $2,785,464 | $7,608,126 | $5,422,099 |
| Cost of revenues | 2,289,867 | 1,902,308 | 4,485,942 | 3,559,332 |
| Marketing | 526,780 | 274,323 | 1,006,002 | 545,593 |
| Technology and development | 317,213 | 267,083 | 617,943 | 524,191 |
| General and administrative | 311,197 | 213,943 | 589,448 | 408,234 |
| Operating income | 462,213 | 127,807 | 908,791 | 384,749 |
| Other income (expense): | | | | |
| Interest expense | (101,605) | (55,482) | (182,824) | (102,224) |
| Interest and other income (expense) | 68,028 | (58,363) | 2,285 | (44,771) |
| Income before income taxes | 428,636 | 13,962 | 728,252 | 237,754 |
| Provision for (benefit from) income taxes | 44,287 | (51,638) | 53,779 | (6,068) |
| Net income | $384,349 | $65,600 | $674,473 | $243,822 |
| Earnings per share: | | | | |
| Basic | $0.88 | $0.15 | $1.55 | $0.57 |
| Diluted | $0.85 | $0.15 | $1.50 | $0.55 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 435,097 | 431,396 | 434,638 | 431,000 |
| Diluted | 451,552 | 446,262 | 450,958 | 445,862 |

See accompanying notes to the consolidated financial statements.

Table of Contents

NETFLIX, INC.
Consolidated Statements of Comprehensive Income
(unaudited)
(in thousands)

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| Net income | $384,349 | $65,600 | $674,473 | $243,822 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustments | (16,691) | 14,347 | 8,130 | 16,926 |
| Change in unrealized gains on available-for-sale securities, net of tax of $0, $89, $0, and $166, respectively | — | 144 | — | 271 |
| Total other comprehensive income (loss) | (16,691) | 14,491 | 8,130 | 17,197 |
| Comprehensive income | $367,658 | $80,091 | $682,603 | $261,019 |

See accompanying notes to the consolidated financial statements.

Table of Contents

NETFLIX, INC.

Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| Cash flows from operating activities: | | | | |
| Net income | $384,349 | $65,600 | $674,473 | $243,822 |
| Adjustments to reconcile net income to net cash used in operating activities: | | | | |
| Additions to streaming content assets | (3,033,721) | (2,664,421) | (6,020,468) | (5,013,087) |
| Change in streaming content liabilities | 288,474 | 514,890 | 667,359 | 881,147 |
| Amortization of streaming content assets | 1,817,817 | 1,550,794 | 3,566,661 | 2,856,477 |
| Amortization of DVD content assets | 11,154 | 16,511 | 22,288 | 35,109 |
| Depreciation and amortization of property, equipment and intangibles | 19,736 | 18,551 | 38,777 | 33,600 |
| Stock-based compensation expense | 81,232 | 44,028 | 149,627 | 88,916 |
| Other non-cash items | 13,921 | 11,519 | 22,130 | 33,185 |
| Foreign currency remeasurement loss (gain) on long-term debt | (85,410) | 64,220 | (44,330) | 64,220 |
| Deferred taxes | (9,539) | (20,702) | (31,588) | (47,466) |
| Changes in operating assets and liabilities: | | | | |
| Other current assets | (25,564) | (80,199) | (81,469) | (105,601) |
| Accounts payable | 7,733 | (12,439) | 81,816 | (23,439) |
| Accrued expenses | (52,851) | (48,042) | 66,198 | 45,500 |
| Deferred revenue | 23,848 | 46,609 | 79,118 | 61,830 |
| Other non-current assets and liabilities | 40,582 | (41,447) | 54,412 | (32,597) |
| Net cash used in operating activities | (518,239) | (534,528) | (754,996) | (878,384) |
| Cash flows from investing activities: | | | | |
| Acquisition of DVD content assets | (12,552) | (7,624) | (23,348) | (32,996) |
| Purchases of property and equipment | (27,323) | (65,231) | (64,493) | (117,754) |
| Change in other assets | (441) | (1,064) | (2,227) | (1,833) |
| Purchases of short-term investments | — | (14,246) | — | (72,020) |
| Proceeds from sale of short-term investments | — | 14,128 | — | 69,876 |
| Proceeds from maturities of short-term investments | — | 17,605 | — | 22,705 |
| Net cash used in investing activities | (40,316) | (56,432) | (90,068) | (132,022) |
| Cash flows from financing activities: | | | | |
| Proceeds from issuance of debt | 1,900,000 | 1,420,510 | 1,900,000 | 1,420,510 |
| Debt issuance costs | (16,992) | (15,013) | (16,992) | (15,013) |
| Proceeds from issuance of common stock | 26,936 | 14,826 | 83,271 | 39,004 |
| Other financing activities | (532) | 63 | (853) | 124 |
| Net cash provided by financing activities | 1,909,412 | 1,420,386 | 1,965,426 | 1,444,625 |
| Effect of exchange rate changes on cash, cash equivalents, and restricted cash | (36,340) | 11,527 | (29,163) | 16,982 |
| Net increase in cash, cash equivalents, and restricted cash | 1,314,517 | 840,953 | 1,091,199 | 451,201 |
| Cash, cash equivalents, and restricted cash at beginning of period | 2,599,477 | 1,077,824 | 2,822,795 | 1,467,576 |
| Cash, cash equivalents, and restricted cash at end of period | $3,913,994 | $1,918,777 | $3,913,994 | $1,918,777 |

| | | | | |
|---|---|---|---|---|
| Supplemental disclosure: | | | | |
| Increase (decrease) in investing activities included in liabilities | $725 | $(3,493) | $4,642 | $(20,165) |

See accompanying notes to the consolidated financial statements.

Table of Contents

NETFLIX, INC.
Consolidated Balance Sheets
(in thousands, except share and par value data)

| | As of June 30, 2018 (unaudited) | December 31, 2017 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $3,906,357 | $2,822,795 |
| Current content assets, net | 4,803,663 | 4,310,934 |
| Other current assets | 636,869 | 536,245 |
| Total current assets | 9,346,889 | 7,669,974 |
| Non-current content assets, net | 12,292,070 | 10,371,055 |
| Property and equipment, net | 349,646 | 319,404 |
| Other non-current assets | 674,932 | 652,309 |
| Total assets | $22,663,537 | $19,012,742 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Current content liabilities | $4,541,087 | $4,173,041 |
| Accounts payable | 448,219 | 359,555 |
| Accrued expenses | 392,595 | 315,094 |
| Deferred revenue | 697,740 | 618,622 |
| Total current liabilities | 6,079,641 | 5,466,312 |
| Non-current content liabilities | 3,604,158 | 3,329,796 |
| Long-term debt | 8,342,067 | 6,499,432 |
| Other non-current liabilities | 141,071 | 135,246 |
| Total liabilities | 18,166,937 | 15,430,786 |
| Commitments and contingencies (Note 6) | | |
| Stockholders' equity: | | |
| Common stock, $0.001 par value; 4,990,000,000 shares authorized at June 30, 2018 and December 31, 2017; 435,457,505 and 433,392,686 issued and outstanding at June 30, 2018 and December 31, 2017, respectively | 2,103,437 | 1,871,396 |
| Accumulated other comprehensive loss | (12,427) | (20,557) |
| Retained earnings | 2,405,590 | 1,731,117 |
| Total stockholders' equity | 4,496,600 | 3,581,956 |
| Total liabilities and stockholders' equity | $22,663,537 | $19,012,742 |

See accompanying notes to the consolidated financial statements.

Table of Contents

NETFLIX, INC.
Notes to Consolidated Financial Statements
(unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying interim consolidated financial statements of Netflix, Inc. and its wholly owned subsidiaries (the "Company") have been prepared in conformity with accounting principles generally accepted in the United States ("U.S.") and are consistent in all material respects with those applied in the Company's Annual Report on Form 10-K, as amended by Form 10-K/A, for the year ended December 31, 2017 filed with the Securities and Exchange Commission (the "SEC") on February 5, 2018. The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include the streaming content asset amortization policy and the recognition and measurement of income tax assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances. On a regular basis, the Company evaluates the assumptions, judgments and estimates. Actual results may differ from these estimates.

The interim financial information is unaudited, but reflects all normal recurring adjustments that are, in the opinion of management, necessary to fairly present the information set forth herein. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K/A, for the year ended December 31, 2017. Interim results are not necessarily indicative of the results for a full year.

The Company has three reportable segments: Domestic streaming, International streaming and Domestic DVD, all of which derive revenue from monthly membership fees. See Note 10 for further detail on the Company's segments.

There have been no material changes in the Company's significant accounting policies, other than the adoption of accounting pronouncements below, as compared to the significant accounting policies described in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2017.

Recently adopted accounting pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued 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 received in exchange for those goods or services. The Company adopted ASU 2014-09 in the first quarter of 2018 using the modified retrospective approach. Because the Company's primary source of revenues is from monthly membership fees which are recognized ratably over each monthly membership period, the impact on its consolidated financial statements is not material.

In November 2016, the FASB issued ASU 2016-18, Restricted Cash, which requires amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The Company adopted ASU 2016-18 in the first quarter of 2018 and the impact on its consolidated financial statements is not material as the Company's restricted cash balances are immaterial.

In January 2018, the FASB released guidance on the accounting for tax on the global intangible low-taxed income ("GILTI") provisions of the Tax Cuts and Jobs Act (the "Act"). The GILTI provisions impose a tax on foreign income in excess of a deemed return on tangible assets of foreign corporations. In the first quarter of 2018, the Company elected to treat any potential GILTI inclusions as a period cost.

Recently issued accounting pronouncements not yet adopted

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under current GAAP. ASU 2016-02 requires that a lessee should recognize a

liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. The Company will adopt ASU 2016-02 in the first quarter of 2019 and is in the process of implementing changes to its systems and processes in conjunction with its review of lease agreements. Although the Company is in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements, the Company currently believes the most significant change will be related to the recognition of right-of-use assets and lease liabilities on the Company's balance sheet for real estate operating leases.

Table of Contents

2. 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 incremental shares issuable upon the assumed exercise of stock options. The computation of earnings per share is as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| | (in thousands, except per share data) | | | |
| Basic earnings per share: | | | | |
| Net income | $384,349 | $65,600 | $674,473 | $243,822 |
| Shares used in computation: | | | | |
| Weighted-average common shares outstanding | 435,097 | 431,396 | 434,638 | 431,000 |
| Basic earnings per share | $0.88 | $0.15 | $1.55 | $0.57 |
| | | | | |
| Diluted earnings per share: | | | | |
| Net income | $384,349 | $65,600 | $674,473 | $243,822 |
| Shares used in computation: | | | | |
| Weighted-average common shares outstanding | 435,097 | 431,396 | 434,638 | 431,000 |
| Employee stock options | 16,455 | 14,866 | 16,320 | 14,862 |
| Weighted-average number of shares | 451,552 | 446,262 | 450,958 | 445,862 |
| Diluted earnings per share | $0.85 | $0.15 | $1.50 | $0.55 |

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. These anti-dilutive stock options were immaterial for each period presented.

Table of Contents

3. Cash, Cash Equivalents and Restricted Cash

| | As of June 30, 2018 | |
|---|---|---|
| | Cash and cash equivalents | Non-current Assets (1) |
| | (in thousands) | |
| Cash | $2,232,132 | $ 6,351 |
| Level 1 securities: | | |
| Money market funds | 1,524,225 | 1,286 |
| Level 2 securities: | | |
| Time Deposits | 150,000 | — |

| | As of December 31, 2017 | |
|---|---|---|
| | Cash and cash equivalents | Non-current Assets (1) |
| | (in thousands) | |
| Cash | $2,072,296 | $ 4,367 |
| Level 1 securities: | | |
| Money market funds | 449,734 | 1,276 |
| Level 2 securities: | | |
| Time Deposits | 300,765 | — |

(1) Restricted cash related to workers compensation deposits and letter of credit agreements. Balance as of June 30, 2018 is included in cash, cash equivalents, and restricted cash on the Consolidated Statements of Cash Flows.

There were no material gross realized gains or losses in the three and six months ended June 30, 2018 and 2017, respectively.

4. Balance Sheet Components

Content Assets

Content assets consisted of the following:

| | As of June 30, 2018 | December 31, 2017 |
|---|---|---|
| | (in thousands) | |
| Licensed content, net | $13,032,400 | $11,771,778 |
| | | |
| Produced content, net | | |
| Released, less amortization | 1,786,221 | 1,427,256 |
| In production | 2,085,501 | 1,311,137 |
| In development and pre-production | 179,060 | 158,517 |
| | 4,050,782 | 2,896,910 |
| DVD, net | 12,551 | 13,301 |
| Total | $17,095,733 | $14,681,989 |
| | | |
| Current content assets, net | $4,803,663 | $4,310,934 |
| Non-current content assets, net | $12,292,070 | $10,371,055 |

On average, over 90% of a licensed or produced streaming content asset is expected to be amortized within four years after its month of first availability.

As of June 30, 2018, over 30% of the $17.1 billion unamortized cost is expected to be amortized within one year and 30% and 81% of the $1.8 billion unamortized cost of the produced content that has been released is expected to be amortized within one year and three years, respectively.

As of June 30, 2018, the amount of accrued participations and residuals was not material.

Property and Equipment, Net

Property and equipment and accumulated depreciation consisted of the following:

| | As of June 30, 2018 | December 31, 2017 | Estimated Useful Lives |
|---|---|---|---|
| | (in thousands) | | |
| Information technology | $215,298 | $ 223,850 | 3 years |
| Furniture and fixtures | 50,513 | 49,217 | 3 years |
| Buildings | 40,681 | 40,681 | 30 years |
| Leasehold improvements | 237,944 | 229,848 | Over life of lease |
| DVD operations equipment | 58,666 | 59,316 | 5 years |
| Corporate aircraft | 57,938 | 30,039 | 8 years |
| Capital work-in-progress | 28,902 | 8,267 | |
| Property and equipment, gross | 689,942 | 641,218 | |
| Less: Accumulated depreciation | (340,296 ) | (321,814 ) | |
| Property and equipment, net | $349,646 | $ 319,404 | |

Deferred Revenue

The Company’s primary source of revenues are from monthly membership fees. Members are billed in advance of the start of their monthly membership and 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. The Company is the principal in all its relationships where partners, including consumer electronics (“CE”) manufacturers, multichannel video programming distributors (“MVPDs”), mobile operators and internet service providers (“ISPs”), provide access to the service as the Company retains control over service delivery to its members. Typically, payments made to the partners, such as for marketing, are expensed, but in the case where the price that the member pays is established by the partners and there is no standalone price for the Netflix service (for instance, in a bundle), these payments are recognized as a reduction of revenues.

Deferred revenue consists of membership fees billed that have not been recognized, as well as gift and other prepaid memberships that have not been fully redeemed. As of June 30, 2018, total deferred revenue was $697.7 million, the vast majority of which was related to membership fees billed that are expected to be recognized as revenue within the next month. The remaining deferred revenue balance, which is related to gift cards and other prepaid memberships, will be recognized as revenue over the period of service after redemption, which is expected to occur over the next 12 months. The $79.1 million increase in deferred revenue as compared to the year ended December 31, 2017 is a result of the increase in membership fees billed due to increased members and average monthly revenue per paying member.

5. Long-term Debt

As of June 30, 2018, the Company had aggregate outstanding long-term notes of $8,342.1 million, net of $74.9 million of issuance costs, with varying maturities (the "Notes"). Each of the Notes were issued at par and are senior unsecured obligations of the Company. Interest is payable semi-annually at fixed rates.

The following table provides a summary of the Company's outstanding long-term debt and the fair values based on quoted market prices in less active markets as of June 30, 2018 and December 31, 2017:

| | Principal Amount at Par (in millions) | Issuance Date | Maturity | Interest Payment Dates | Level 2 Fair Value as of June 30, 2018 | Level 2 Fair Value as of December 31, 2017 |
|---|---|---|---|---|---|---|
| | | | | | (in millions) | |
| 5.375% Senior Notes | $ 500 | February 2013 | February 2021 | February 1 and August 1 | $516 | $ 530 |
| 5.750% Senior Notes | 400 | February 2014 | March 2024 | March 1 and September 1 | 411 | 427 |
| 5.875% Senior Notes | 800 | February 2015 | February 2025 | April 15 and October 15 | 822 | 856 |
| 5.50% Senior Notes | 700 | February 2015 | February 2022 | April 15 and October 15 | 723 | 739 |
| 4.375% Senior Notes | 1,000 | October 2016 | November 2026 | May 15 and November 15 | 942 | 983 |
| 3.625% Senior Notes (1) | 1,517 | May 2017 | May 2027 | May 15 and November 15 | 1,491 | 1,575 |
| 4.875% Senior Notes | 1,600 | October 2017 | April 2028 | April 15 and October 15 | 1,526 | 1,571 |
| 5.875% Senior Notes | $ 1,900 | April 2018 | November 2028 | May 15 and November 15 | 1,923 | — |
| | $ 8,417 | | | | | |

(1) Debt is denominated in euro with a €1,300 million aggregate principal amount and is remeasured into U.S. dollars at each balance sheet date.

The expected timing of principal and interest payments for these Notes are as follows:

Table of Contents

| | As of June 30, 2018 | December 31, 2017 |
|---|---|---|
| | (in thousands) | |
| Less than one year | $429,942 | $ 311,339 |
| Due after one year and through three years | 1,347,480 | 627,444 |
| Due after three years and through five years | 1,448,814 | 1,761,465 |
| Due after five years | 8,687,586 | 6,348,580 |
| Total debt obligations | $11,913,822 | $ 9,048,828 |

Each of the 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 Notes prior to maturity in whole or in part at an amount equal to the principal amount thereof plus accrued and unpaid interest and an applicable premium. The 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 certain 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. As of June 30, 2018 and December 31, 2017, the Company was in compliance with all related covenants.

Revolving Credit Facility

In July 2017, the Company entered into a $500.0 million unsecured revolving credit facility (“Revolving Credit Agreement”), with an uncommitted incremental facility to increase the amount of the revolving credit facility by up to an additional $250.0 million, subject to certain terms and conditions. Revolving loans may be borrowed, repaid and reborrowed until July 27, 2022, at which time all amounts borrowed must be repaid. The Company may use the proceeds of future borrowings under the Revolving Credit Agreement for working capital and general corporate purposes. As of June 30, 2018, no amounts have been borrowed under the Revolving Credit Agreement.

The borrowings under the Revolving Credit Agreement bear interest, at the Company’s option, of either (i) a floating rate equal to a base rate (the “Alternate Base Rate”) or (ii) a rate equal to an adjusted London interbank offered rate (the “Adjusted LIBO Rate”), plus a margin of 0.75%. The Alternate Base Rate is defined as the greatest of (A) the rate of interest published by the Wall Street Journal, from time to time, as the prime rate, (B) the federal funds rate, plus 0.500% and (C) the Adjusted LIBO Rate for a one-month interest period, plus 1.00%. The Adjusted LIBO Rate is defined as the London interbank offered rate for deposits in U.S. dollars, for the relevant interest period, adjusted for statutory reserve requirements, but in no event shall the Adjusted LIBO Rate be less than 0.00% per annum.

The Company is also obligated to pay a commitment fee on the undrawn amounts of the Revolving Credit Agreement at a rate of 0.10%. The Revolving Credit Agreement requires the Company to comply with certain covenants, including covenants that limit or restrict the ability of the Company’s subsidiaries to incur debt and limit or restrict the ability of the Company and its subsidiaries to grant liens and enter into sale and leaseback transactions; and, in the case of the Company or a guarantor, merge, consolidate, liquidate, dissolve or sell, transfer, lease or otherwise dispose of all or substantially all of the assets of the Company and its subsidiaries, taken as a whole. As of June 30, 2018, the Company was in compliance with all related covenants.

6. Commitments and Contingencies

Streaming Content

As of June 30, 2018, the Company had $18.4 billion of obligations comprised of $4.5 billion included in "Current content liabilities" and $3.6 billion of "Non-current content liabilities" on the Consolidated Balance Sheets and $10.3 billion of obligations that are not reflected on the Consolidated Balance Sheets as they did not yet meet the criteria for asset recognition.

As of December 31, 2017, the Company had $17.7 billion of obligations comprised of $4.2 billion included in "Current content liabilities" and $3.3 billion of "Non-current content liabilities" on the Consolidated Balance Sheets

and $10.2 billion of obligations that are not reflected on the Consolidated Balance Sheets as they did not yet meet the criteria for asset recognition.

The expected timing of payments for these streaming content obligations is as follows:

Table of Contents

| | As of June 30, 2018 | December 31, 2017 |
|---|---|---|
| | (in thousands) | |
| Less than one year | $8,212,614 | $7,446,947 |
| Due after one year and through three years | 8,374,640 | 8,210,159 |
| Due after three years and through five years | 1,718,511 | 1,894,001 |
| Due after five years | 93,001 | 143,535 |
| Total streaming content obligations | $18,398,766 | $17,694,642 |

Content obligations include amounts related to the acquisition, licensing and production of streaming content. Obligations that are in non-U.S. dollar currencies are translated to the U.S. dollar at period end rates. An obligation for the production of content includes non-cancelable commitments under creative talent and employment agreements as well as other production related commitments. An obligation for the acquisition and licensing of content is incurred at the time the Company enters into an agreement to obtain future titles. Once a title becomes available, a content liability is 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. Traditional film output deals, or certain TV series license agreements where the number of seasons to be aired is unknown, are examples of such license agreements. 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.

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.

The Company is involved in litigation matters not listed herein 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.

Indemnification

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 consolidated financial statements with respect to these indemnification obligations.

7. Stockholders’ Equity

Stock Option Plan

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 June 30, 2018, 9.7 million shares were reserved for future grants under the 2011 Stock Plan.

Table of Contents

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

| | | Options Outstanding | | | |
|---|---|---|---|---|---|
| | Shares Available for Grant | Number of Shares | Weighted-Average Exercise Price (per share) | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in thousands) |
| Balances as of December 31, 2017 | 10,739,915 | 21,647,350 | $ 61.13 | | |
| Granted | (1,056,538 ) | 1,056,538 | 282.22 | | |
| Exercised | — | (2,064,819 ) | 39.92 | | |
| Expired | — | (1,820 ) | 4.72 | | |
| Balances as of June 30, 2018 | 9,683,377 | 20,637,249 | $ 74.58 | 5.85 | $ 6,538,997 |
| Vested and exercisable as of June 30, 2018 | | 20,637,249 | $ 74.58 | 5.85 | $ 6,538,997 |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the second quarter of 2018 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 the second quarter of 2018. This amount changes based on the fair market value of the Company's common stock.

A summary of the amounts related to option exercises, is as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| | (in thousands) | | | |
| Total intrinsic value of options exercised | $246,795 | $101,727 | $524,705 | $208,824 |
| Cash received from options exercised | 26,936 | 14,826 | 83,271 | 39,004 |

Stock-based Compensation

Stock options granted are 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:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| Dividend yield | — % | — % | — % | — % |
| Expected volatility | 42 % | 34 % | 40% - 42% | 34% - 37% |
| Risk-free interest rate | 2.90 % | 2.37 % | 2.61 % - 2.90% | 2.37%-2.45% |
| Suboptimal exercise factor | 2.93 | 2.51 | 2.80 - 2.93 | 2.48 - 2.51 |
| Weighted-average fair value (per share) | $161.39 | $67.21 | $141.62 | $ 64.67 |
| Total stock-based compensation expense (in thousands) | $81,232 | $44,028 | $149,627 | $ 88,916 |
| Total income tax impact on provision (in thousands) | $16,889 | $14,477 | $31,580 | $ 29,178 |

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

The Company calculates expected volatility based solely on implied volatility. The Company believes that implied volatility of publicly traded options in its common stock is more reflective of market conditions, and given

consistently high trade volumes of the options, can reasonably be expected to be a better indicator of expected volatility than historical volatility of its common stock.

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.

Table of Contents

8. Accumulated Other Comprehensive Loss

The accumulated balance of other comprehensive loss, net of tax, for the three and six months ended June 30, 2018 decreased $16.7 million and increased $8.1 million, respectively, due to cumulative translation adjustments for its non-US dollar functional currency subsidiaries.

9. Income Taxes

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| | (in thousands, except percentages) | | | |
| Provision for (benefit from) income taxes | $44,287 | $(51,638) | $53,779 | $(6,068) |
| Effective tax rate | 10 % | (370)% | 7 % | (3)% |

The effective tax rates for the three and six months ended June 30, 2018 differed from the Federal statutory rate primarily due to the recognition of excess tax benefits of stock-based compensation and Federal and California research and development credits (“R&D”), partially offset by state taxes, foreign taxes, non-deductible expenses, and the international provisions from the U.S. tax reform enacted in December 2017. The effective tax rate for the three and six months ended June 30, 2017 differed from the Federal statutory rate primarily due to the recognition of excess tax benefits of stock-based compensation, foreign income taxed at rates lower than the U.S. statutory rate and Federal and California R&D credits, partially offset by state taxes and non-deductible expenses.

The increase in effective tax rates for the three and six months ended June 30, 2018 as compared to the same periods in 2017 were due primarily to lower benefit on a percentage basis from the recognition of excess tax benefits of stock-based compensation as well as additional expense related to foreign taxes, non-deductible expenses, and the international provisions from the U.S. tax reform enacted in December 2017. For the three and six months ended June 30, 2018, the Company recognized a discrete tax benefit related to the excess tax benefits from stock-based compensation of $56.7 million and $117.4 million, respectively, compared to the three and six months ended June 30, 2017 of $32.8 million and $68.8 million, respectively.

In December 2017, the Tax Cuts and Jobs Act of 2017 (the “Act”) was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, the transition of U.S. international taxation from a worldwide tax system to a territorial system, and a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017.

On December 22, 2017, Staff Accounting Bulletin No. 118 (“SAB 118”) was issued to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Act. Additional work is still necessary for a more detailed analysis of the Company's deferred tax assets and liabilities and its historical foreign earnings as well as potential correlative adjustments. Any subsequent adjustment to these amounts will be recorded to current tax expense in the quarter of 2018 when the analysis is complete.

Gross unrecognized tax benefits were $56.1 million and $42.9 million as of June 30, 2018 and December 31, 2017, respectively. The gross unrecognized tax benefits, if recognized by the Company, will result in a reduction of approximately $52.3 million to the provision for income taxes thereby favorably impacting the Company’s effective tax rate. As of June 30, 2018, gross unrecognized tax benefits of $28.5 million was classified as “Other non-current liabilities” and $27.6 million as a reduction to deferred tax assets which was classified as "Other non-current assets" in the Consolidated Balance Sheets. The Company includes interest and penalties related to unrecognized tax benefits within the "Provision for (benefit from) income taxes" on the Consolidated Statements of Operations and “Other non-current liabilities” in the Consolidated Balance Sheets. Interest and penalties included in the Company’s “Provision

for (benefit from) income taxes" were not material in any of the periods presented.

Deferred tax assets of $509.9 million and $478.3 million were classified as "Other non-current assets" on the Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017, 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. The Company has a valuation allowance of $103.4 million and $49.4 million as of June 30, 2018 and December 31, 2017, respectively. The valuation allowance is primarily related to certain foreign tax credit carryovers that are not likely to be recognized.

The Company files U.S. Federal, state and foreign tax returns. The Company is currently under examination by the IRS and the state of California for 2014 and 2015. The 2016 Federal tax return remains subject to examination by the IRS. The 2009 through 2016 state tax returns are subject to examination by state tax authorities. The Company is also currently under examination in the UK for 2015. The Company has no other significant foreign jurisdiction audits underway. The years 2012 through 2017 remain subject to examination by foreign tax authorities.

Table of Contents

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. At this time, an estimate of the range of reasonably possible adjustments to the balance of unrecognized tax benefits cannot be made.

10. Segment Information

The Company has three reportable segments: Domestic streaming, International streaming and Domestic DVD. Segment information is presented in the same manner that the Company's chief operating decision maker ("CODM") reviews the operating results in assessing performance and allocating resources. The Company's CODM reviews revenues and contribution profit (loss) for each of the reportable segments. Contribution profit (loss) is defined as revenues less cost of revenues and marketing expenses 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.

The Domestic streaming segment derives revenues from monthly membership fees for services consisting solely of streaming content to members in the United States. The International streaming segment derives revenues from monthly membership fees for services consisting solely of streaming content to members outside of the United States. 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.

Amortization of streaming content assets makes up the vast majority of cost of revenues. The Company obtains multi-territory or global rights for its streaming content and allocates these rights between Domestic and International streaming segments based on estimated fair market value. Amortization of content assets and other expenses associated with the acquisition, licensing, and production of streaming content for each streaming segment thus includes both expenses directly incurred by the segment as well as an allocation of expenses incurred for global or multi-territory rights. Other costs of revenues such as delivery costs are primarily attributed to the operating segment based on amounts directly incurred by the segment. Marketing expenses consist primarily of advertising expenses and certain payments made to marketing partners, including CE manufacturers, MVPDs, mobile operators and ISPs, 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 June 30, 2018 | December 31, 2017 |
|---|---|---|
| | (in thousands) | |
| United States | $312,872 | $289,875 |
| International | 36,774 | 29,529 |

The following tables represent segment information for the three and six months ended June 30, 2018:

| | As of/ Three Months Ended June 30, 2018 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total memberships at end of period (1) | 57,379 | 72,762 | 2,999 | — |
| Revenues | $1,893,222 | $1,921,144 | $92,904 | $3,907,270 |
| Cost of revenues | 925,703 | 1,324,240 | 39,924 | 2,289,867 |
| Marketing | 227,961 | 298,819 | — | 526,780 |
| Contribution profit | $739,558 | $298,085 | $52,980 | $1,090,623 |
| Other operating expenses | | | | 628,410 |

| | |
|---|---|
| Operating income | 462,213 |
| Other income (expense) | (33,577) |
| Provision for income taxes | 44,287 |
| Net income | $384,349 |

Table of Contents

| | As of/ Six Months Ended June 30, 2018 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total memberships at end of period (1) | 57,379 | 72,762 | 2,999 | — |
| Revenues | $3,713,241 | $3,703,230 | $191,655 | $7,608,126 |
| Cost of revenues | 1,820,576 | 2,583,049 | 82,317 | 4,485,942 |
| Marketing | 455,983 | 550,019 | — | 1,006,002 |
| Contribution profit | $1,436,682 | $570,162 | $109,338 | $2,116,182 |
| Other operating expenses | | | | 1,207,391 |
| Operating income | | | | 908,791 |
| Other income (expense) | | | | (180,539) |
| Provision for income taxes | | | | 53,779 |
| Net income | | | | $674,473 |

The following tables represent segment information for the three and six months ended June 30, 2017:

| | As of/ Three Months Ended June 30, 2017 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total memberships at end of period (1) | 51,921 | 52,031 | 3,758 | — |
| Revenues | $1,505,499 | $1,165,228 | $114,737 | $2,785,464 |
| Cost of revenues | 831,962 | 1,017,612 | 52,734 | 1,902,308 |
| Marketing | 113,608 | 160,715 | — | 274,323 |
| Contribution profit (loss) | $559,929 | $(13,099) | $62,003 | $608,833 |
| Other operating expenses | | | | 481,026 |
| Operating income | | | | 127,807 |
| Other income (expense) | | | | (113,845) |
| Benefit from income taxes | | | | (51,638) |
| Net income | | | | $65,600 |

| | As of/Six Months Ended June 30, 2017 | | | |
|---|---|---|---|---|
| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
| | (in thousands) | | | |
| Total memberships at end of period (1) | 51,921 | 52,031 | 3,758 | — |
| Revenues | $2,975,541 | $2,211,427 | $235,131 | $5,422,099 |
| Cost of revenues | 1,581,450 | 1,864,929 | 112,953 | 3,559,332 |
| Marketing | 228,646 | 316,947 | — | 545,593 |
| Contribution profit | $1,165,445 | $29,551 | $122,178 | $1,317,174 |
| Other operating expenses | | | | 932,425 |
| Operating income | | | | 384,749 |
| Other income (expense) | | | | (146,995) |
| Benefit from income taxes | | | | (6,068) |
| Net income | | | | $243,822 |

Table of Contents

The following table represents the amortization of content assets:

| | Domestic Streaming | International Streaming | Domestic DVD | Consolidated |
|---|---|---|---|---|
| | (in thousands) | | | |
| Three months ended June 30, | | | | |
| 2018 | $751,947 | $1,065,870 | $11,154 | $1,828,971 |
| 2017 | 696,688 | 854,106 | 16,511 | 1,567,305 |
| Six months ended June 30, | | | | |
| 2018 | 1,482,219 | 2,084,442 | 22,288 | 3,588,949 |
| 2017 | 1,305,436 | 1,551,041 | 35,109 | 2,891,586 |

(1) A membership (also referred to as a subscription) is defined as the right to receive Netflix service following sign-up and a method of payment being provided. 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 certain new and rejoining members. Total members include those who are on a free-trial as long as a method of payment has been provided. 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.

Table of Contents

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains 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 impact of, and the Company’s response to, new accounting standards; content amortization; pricing changes; dividends; impact of foreign currency and exchange rate fluctuations, including on net income, revenues and average revenues per paying member; deferred revenue; investments in global streaming, including original content; impact of content on membership growth; cash use in connection with the acquisition, licensing and production of content; liquidity and free cash flow; unrecognized tax benefits; deferred tax assets; effective tax rate; accessing and obtaining additional capital, including future debt financing; accounting treatment for changes related to content assets; and future contractual obligations, including unknown streaming content obligations and timing of payments. These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially from those included in forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in our Annual Report on Form 10-K, as amended by Form 10-K/A, for the year ended December 31, 2017 filed with the Securities and Exchange Commission (“SEC”) on February 5, 2018, in particular the risk factors discussed under the heading “Risk Factors” in Part I, Item IA.

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

Investors and others should note that we announce material financial information to our investors using our investor relations Web site (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 United States ("U.S.") social media channels listed on our investor relations Web site.

Overview

We are the world’s leading internet entertainment service with over 130 million streaming memberships in over 190 countries enjoying TV series, documentaries and feature films across a wide variety of genres and languages. Members can watch as much as they want, anytime, anywhere, on any internet-connected screen. Members can play, pause and resume watching, all without commercials or commitments. Additionally, in the 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 added increasing amounts of content that enable consumers to enjoy TV shows and movies directly on their internet-connected screens. 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. Historically, the first and fourth quarters (October through March) represent our greatest membership growth across our Domestic and International streaming segments. Increasingly, our membership growth is impacted by the release of certain high-profile original content, which may affect historical seasonal patterns. Internationally, we expect each market 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.

Our core strategy is to grow our streaming membership business globally within the parameters of our profit margin 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. In addition, we are continuously enhancing our user interface and extending our streaming service to more internet-connected screens. Our members can download a selection of titles for offline viewing.

19

Table of Contents

Results of Operations

The following represents our consolidated performance highlights:

| | As of/ Three Months Ended | | Change | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 | |
| | (in thousands, except revenue per membership and percentages) | | | |
| Global streaming memberships at end of period | 130,141 | 103,952 | 26,189 | 25 % |
| Global streaming average monthly revenue per paying membership | $10.45 | $9.21 | $1.24 | 13 % |
| Revenues | 3,907,270 | 2,785,464 | 1,121,806 | 40 % |
| Global operating income | 462,213 | 127,807 | 334,406 | 262% |
| Global operating margin | 11.8 % | 4.6 % | 7.2 % | 157% |
| Net income | 384,349 | 65,600 | 318,749 | 486% |

Consolidated revenues for the three months ended June 30, 2018 increased 40%, including an increase of 26% and 65% in revenues in the Domestic streaming and International streaming segments, respectively, as compared to the three months ended June 30, 2017. International revenues accounted for 49% of consolidated revenue for the three months ended June 30, 2018 as compared to 42% of consolidated revenue for the three months ended June 30, 2017. The increase in consolidated revenues was primarily driven by the growth in the average number of paid streaming memberships globally, the majority of which was growth in our international memberships. Average paid international streaming memberships accounted for 54% of total average paid streaming memberships as of June 30, 2018, as compared to 48% of total average paid streaming memberships for the same period in 2017. In addition, the average monthly revenue per paying streaming membership increased primarily due to price changes and a shift in the plan mix towards higher priced plans.

The increase in operating income is due primarily to increased revenues partially offset by increased content expenses as we continue to acquire, license and produce content, including more Netflix originals, as well as increased headcount costs to support continued improvements in our streaming service, our international expansion, and our growing content production activities. The increase in net income was comprised of an increase in operating income coupled with an increase in foreign exchange gains primarily due to the remeasurement of our euro denominated senior note, partially offset by an increase in interest expense primarily due to the higher principal of senior notes outstanding.

We offer three types of streaming membership plans. Our “basic” plan includes access to standard definition quality streaming on a single screen at a time. Our “standard” plan is our most popular streaming plan and includes access to high definition quality streaming on two screens concurrently. Our “premium” plan includes access to high definition and ultra-high definition quality content on four screens concurrently. As of June 30, 2018, pricing on our plans ranged in the U.S. from $7.99 to $13.99 per month and internationally from the U.S. dollar equivalent of approximately $4 to $20 per month. We expect that from time to time the prices of our membership plans in each country may increase.

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

- We define contribution profit (loss) as revenues less cost of revenues and marketing expenses incurred by the segment. It represents each segment's performance before global corporate costs. As markets within our International streaming segment become profitable, we increasingly focus on our global operating margin as a measure of profitability.
- For the Domestic and International streaming segments, amortization of the streaming content assets makes up the vast majority of cost of revenues. Increasingly, we obtain multi-territory or global rights for our streaming content and allocate these rights between Domestic and International streaming segments based on estimated fair market value.

Expenses associated with the acquisition, licensing and production of streaming content, streaming delivery costs and other operations costs make up the remainder of cost of revenues. We have built our own global content delivery network (“Open Connect”) to help us efficiently stream a high volume of content to our members over the internet. Streaming delivery expenses, therefore, include equipment costs related to Open Connect and all third-party costs, such as cloud computing costs, associated with delivering streaming content over the internet. Other operations costs include customer service and payment processing fees, including those we pay to our integrated payment partners, as well as other costs incurred in making our content available to members.

- For the Domestic and International streaming segments, marketing expenses consist primarily of advertising expenses and certain payments made to our marketing partners, including consumer electronics manufacturers, MVPD's, mobile operators and ISP's. Advertising expenses include promotional activities such as digital and television advertising. Marketing expenses are incurred by our Domestic and International streaming segments given our focus on building consumer awareness of the streaming offerings, and in particular our original content.

Table of Contents

Domestic Streaming Segment

Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | As of/ Three Months Ended | | Change | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 | |
| | (in thousands, except revenue per membership and percentages) | | | |
| Memberships: | | | | |
| Net additions | 674 | 1,067 | (393) | (37)% |
| Memberships at end of period | 57,379 | 51,921 | 5,458 | 11 % |
| Paid memberships at end of period | 55,959 | 50,323 | 5,636 | 11 % |
| Average monthly revenue per paying membership | $11.37 | $10.07 | $1.30 | 13 % |
| | | | | |
| Contribution profit: | | | | |
| Revenues | $1,893,222 | $1,505,499 | $387,723 | 26 % |
| Cost of revenues | 925,703 | 831,962 | 93,741 | 11 % |
| Marketing | 227,961 | 113,608 | 114,353 | 101 % |
| Contribution profit | 739,558 | 559,929 | 179,629 | 32 % |
| Contribution margin | 39 % | 37 % | | |

In the Domestic streaming segment, we derive revenues from monthly membership fees for services consisting solely of streaming content to our members in the United States. The 26% increase in our domestic streaming revenues was primarily due to the 11% growth in the average number of paid memberships, as well as a 13% increase in the average monthly revenue per paying membership, resulting from our price changes and a shift in the plan mix towards higher priced plans. Our standard plan continues to be the most popular plan choice for new memberships.

The increase in domestic streaming cost of revenues was primarily due to a $55.3 million increase in content amortization relating to our existing and new streaming content, including more exclusive and original programming. Other costs increased $38.4 million primarily due to an increase in other content-related costs, and an increase in payment processing fees which grew due to our growing member base.

Domestic marketing expenses increased primarily due to increased advertising and public relations, as well as increased payments to our partners.

Our Domestic streaming segment had a contribution margin of 39% for the three months ended June 30, 2018 and increased as compared to the contribution margin of 37% for the three months ended June 30, 2017 as growth in paid memberships and revenue outpaced content spend.

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

| | As of/ Six Months Ended | | Change | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | YTD'18 vs. YTD'17 | |
| | (in thousands, except revenue per membership and percentages) | | | |
| Memberships: | | | | |
| Net additions | 2,629 | 2,490 | 139 | 6 % |
| Memberships at end of period | 57,379 | 51,921 | 5,458 | 11% |
| Paid memberships at end of period | 55,959 | 50,323 | 5,636 | 11% |
| Average monthly revenue per paying membership | $11.31 | $10.07 | $1.24 | 12% |
| | | | | |
| Contribution profit: | | | | |
| Revenues | $3,713,241 | $2,975,541 | $737,700 | 25% |

| | | | | |
|---|---|---|---|---|
| Cost of revenues | 1,820,576 | 1,581,450 | 239,126 | 15% |
| Marketing | 455,983 | 228,646 | 227,337 | 99% |
| Contribution profit | 1,436,682 | 1,165,445 | 271,237 | 23% |
| Contribution margin | 39 % | 39 % | | |

Table of Contents

The 25% increase in our domestic streaming revenues was primarily due to the 11% growth in the average number of paid memberships, as well as a 12% increase in average monthly revenue per paying membership, resulting from our price changes and a shift in the plan mix towards higher priced plans.
The increase in domestic streaming cost of revenues was primarily due to a $176.8 million increase in content amortization relating to our existing and new streaming content, including more exclusive and original programming. Other costs increased $62.3 million primarily due to an increase in other content-related costs, and an increase in payment processing fees which grew due to our growing member base.
Domestic marketing expenses increased primarily due to increased advertising and public relations, as well as increased payments to our partners.
Our Domestic streaming segment had a contribution margin of 39% for the six months ended June 30, 2018, which remained flat when compared to the six months ended June 30, 2017.

International Streaming Segment
Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | As of/ Three Months Ended | | Change | | |
|---|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 | | |
| | (in thousands, except revenue per membership and percentages) | | | | |
| Memberships: | | | | | |
| Net additions | 4,472 | 4,137 | 335 | 8 | % |
| Memberships at end of period | 72,762 | 52,031 | 20,731 | 40 | % |
| Paid memberships at end of period | 68,395 | 48,713 | 19,682 | 40 | % |
| Average monthly revenue per paying membership | $9.69 | $8.29 | $1.40 | 17 | % |
| | | | | | |
| Contribution profit (loss): | | | | | |
| Revenues | $1,921,144 | $1,165,228 | $755,916 | 65 | % |
| Cost of revenues | 1,324,240 | 1,017,612 | 306,628 | 30 | % |
| Marketing | 298,819 | 160,715 | 138,104 | 86 | % |
| Contribution profit (loss) | 298,085 | (13,099) | 311,184 | 2,376 | % |
| Contribution margin | 16% | (1)% | | | |

In the International streaming segment, we derive revenues from monthly membership fees for services consisting solely of streaming content to our members outside the United States. The 65% increase in our international revenues was due to the 41% growth in the average number of paid international memberships, in addition to a 17% increase in the average monthly revenue per paying membership. The increase in the average monthly revenue per paying membership was due to price changes and a shift in the plan mix towards higher priced plans coupled with favorable fluctuations in foreign exchange rates. We estimate that international revenues in the second quarter of 2018 would have been approximately $65.0 million lower if foreign exchange rates had remained consistent with the foreign exchange rates from the second quarter of 2017. If foreign currency exchange rates fluctuate more than expected, revenues and average revenue per paying membership may differ from our expectations.
The increase in international cost of revenues was primarily due to a $211.8 million increase in content amortization relating to our existing and new streaming content, including more exclusive and original programming. Other costs increased $94.8 million primarily due to increases in other content-related costs, as well as 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 increased mainly due to increased advertising and public relations, as well as increased payments to our partners.

International contribution profit for the three months ended June 30, 2018 was $298.1 million as opposed to a contribution loss of $13.1 million for the three months ended June 30, 2017 as profit growth in our more mature markets offset investments in newer markets.

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

Table of Contents

| | As of/ Six Months Ended | | Change | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | YTD'18 vs. YTD'17 | |
| | (in thousands, except revenue per membership and percentages) | | | |
| Memberships: | | | | |
| Net additions | 9,930 | 7,666 | 2,264 | 30 % |
| Memberships at end of period | 72,762 | 52,031 | 20,731 | 40 % |
| Paid memberships at end of period | 68,395 | 48,713 | 19,682 | 40 % |
| Average monthly revenue per paying membership | $9.73 | $8.20 | $1.53 | 19 % |
| | | | | |
| Contribution profit: | | | | |
| Revenues | $3,703,230 | $2,211,427 | $1,491,803 | 67 % |
| Cost of revenues | 2,583,049 | 1,864,929 | 718,120 | 39 % |
| Marketing | 550,019 | 316,947 | 233,072 | 74 % |
| Contribution profit | 570,162 | 29,551 | 540,611 | 1,829 % |
| Contribution margin | 15 % | 1 % | | |

The 67% increase in our international revenues was due to the 41% growth in our average number of paid international memberships, in addition to a 19% increase in the average monthly revenue per paying membership. The increase in the average monthly revenue per paying membership was due to price changes and a shift in the plan mix towards higher priced plans coupled with favorable fluctuations in foreign exchange rates. We estimate that international revenues in the six months ended June 30, 2018 would have been approximately $179.3 million lower if foreign exchange rates had remained consistent with the foreign exchange rates for the six months ended June 30, 2017.

The increase in international cost of revenues was primarily due to a $533.4 million increase in content amortization relating to our existing and new streaming content, including more exclusive and original programming. Other costs increased $184.7 million primarily due to increases increases in other content-related costs, as well as 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, partially offset by decreases resulting from exchange rate fluctuations.

International marketing expenses for the six months ended June 30, 2018 increased mainly due to increased advertising and public relations, as well as increased payments to our partners.

International contribution profit grew to $570.2 million for the six months ended June 30, 2018 as compared to $29.6 million profit for the six months ended June 30, 2017 as profit growth in our more mature markets offset investments in newer markets.

Domestic DVD Segment

Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | As of/ Three Months Ended | | Change | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 | |
| | (in thousands, except revenue per membership and percentages) | | | |
| Memberships: | | | | |
| Net losses | (168) | (186) | 18 | 10 % |
| Memberships at end of period | 2,999 | 3,758 | (759) | (20)% |
| Paid memberships at end of period | 2,971 | 3,692 | (721) | (20)% |
| Average monthly revenue per paying membership | $10.14 | $10.12 | $0.02 | — % |

| | | | | |
|---|---|---|---|---|
| Contribution profit: | | | | |
| Revenues | $92,904 | $114,737 | $(21,833) | (19)% |
| Cost of revenues | 39,924 | 52,734 | (12,810) | (24)% |
| Contribution profit | 52,980 | 62,003 | (9,023) | (15)% |
| Contribution margin | 57% | 54% | | |

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 $14.99 per month according to the plan chosen by the member. DVD-by-mail plans differ by the number of DVDs that a

Table of Contents

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 $3 per month for our most popular plans. Cost of revenues in the Domestic DVD segment consist primarily of delivery expenses such as packaging and postage costs, content expenses, and other expenses associated with our DVD processing and customer service centers. The number of memberships to our DVD-by-mail offering is declining, and we anticipate that this decline will continue.
Our Domestic DVD segment contribution margin was 57% for the three months ended June 30, 2018, as compared to 54% for the three months ended June 30, 2017, due to the decreased DVD usage by paying members and decreased DVD content expenses.

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

| | As of/ Six Months Ended | | Change | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | YTD'18 vs. YTD'17 | |
| | (in thousands, except revenue per membership and percentages) | | | |
| Memberships: | | | | |
| Net losses | (384) | (356) | (28) | (8)% |
| Memberships at end of period | 2,999 | 3,758 | (759) | (20)% |
| Paid memberships at end of period | 2,971 | 3,692 | (721) | (20)% |
| Average monthly revenue per paying membership | $10.16 | $10.14 | $0.02 | — % |
| | | | | |
| Contribution profit: | | | | |
| Revenues | $191,655 | $235,131 | $(43,476) | (18)% |
| Cost of revenues | 82,317 | 112,953 | (30,636) | (27)% |
| Contribution profit | 109,338 | 122,178 | (12,840) | (11)% |
| Contribution margin | 57% | 52% | | |

Our Domestic DVD segment contribution margin was 57% for the six months ended June 30, 2018, as compared to 52% for the six months ended June 30, 2017, due to the decreased DVD usage by paying members and decreased DVD content expenses.

Consolidated Operating Expenses

Technology and Development

Technology and development expenses consist of payroll and related expenses for all technology personnel, as well as other costs incurred in making improvements to our service offerings, including testing, maintaining and modifying our user interface, our recommendation, merchandising and streaming delivery technology and infrastructure. Technology and development expenses also include costs associated with computer hardware and software.

Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | Three Months Ended | | Change | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 | |
| | (in thousands, except percentages) | | | |
| Technology and development | $317,213 | $267,083 | $50,130 | 19% |
| As a percentage of revenues | 8% | 10% | | |

The increase in technology and development expenses was primarily due to a $45.8 million increase in personnel-related costs, including stock-based compensation expense, resulting from an increase in compensation for existing employees and growth in average headcount supporting continued improvements in our streaming service and our international expansion.

Table of Contents

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

| | Six Months Ended | | Change |
|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | YTD'18 vs. YTD'17 |
| | (in thousands, except percentages) | | |
| Technology and development | $617,943 | $524,191 | $93,752 18% |
| As a percentage of revenues | 8 % | 10 % | |

The increase in technology and development expenses was primarily due to a $83.6 million increase in personnel-related costs, including stock-based compensation expense, resulting from an increase in compensation for existing employees and a growth in average headcount supporting continued improvements in our streaming service and our international expansion.

General and Administrative

General and administrative expenses consist of payroll and related expenses for corporate personnel, as well as for personnel that support global functions related to content, marketing, public relations and operations other than customer service. General and administrative expenses also includes professional fees and other general corporate expenses.

Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | Three Months Ended | | Change |
|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 |
| | (in thousands, except percentages) | | |
| General and administrative | $311,197 | $213,943 | $97,254 45% |
| As a percentage of revenues | 8 % | 8 % | |

General and administrative expenses increased primarily due to a $79.3 million increase in personnel-related costs, including stock-based compensation expense, resulting from an increase in average headcount primarily to support our international and original content expansion, and an increase in compensation for existing employees. In addition, facilities-related costs increased $11.4 million, primarily driven by costs for our Los Gatos, California headquarters and Los Angeles, California facility. Third party expenses, including costs for contractors and consultants, also increased $4.5 million.

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

| | Six Months Ended | | Change |
|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | YTD'18 vs. YTD'17 |
| | (in thousands, except percentages) | | |
| General and administrative | $589,448 | $408,234 | $181,214 44% |
| As a percentage of revenues | 8 % | 8 % | |

General and administrative expenses increased primarily due to a $147.4 million increase in personnel-related costs, including stock-based compensation expense, resulting from an increase in average headcount primarily to support our international and original content expansion, and an increase in compensation for existing employees. In addition, facilities-related costs increased $17.5 million, primarily driven by costs for our Los Gatos, California headquarters and Los Angeles, California facility. In addition, third party expenses, including costs for contractors and consultants,

increased $10.2 million.

Table of Contents

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.

Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | Three Months Ended | | Change |
|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 |
| | (in thousands, except percentages) | | |
| Interest expense | $(101,605) | $(55,482) | $(46,123) (83)% |
| As a percentage of revenues | (3)% | (2)% | |

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

| | Six Months Ended | | Change |
|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | YTD'18 vs. YTD'17 |
| | (in thousands, except percentages) | | |
| Interest expense | $(182,824) | $(102,224) | $(80,600) (79)% |
| As a percentage of revenues | (2)% | (2)% | |

Interest expense primarily consisted of interest on our Notes of $98.7 million and $177.3 million for the three and six months ended June 30, 2018, respectively. The increase in interest expense for the three and six months ended June 30, 2018 as compared to the three and six months ended June 30, 2017 is due to the increase in long-term debt.

Interest and Other Income (Expense)

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

Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | Three Months Ended | | Change |
|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | Q2'18 vs. Q2'17 |
| | (in thousands, except percentages) | | |
| Interest and other income (expense) | $68,028 | $(58,363) | $126,391 217% |
| As a percentage of revenues | 2% | (2)% | |

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

| | Six Months Ended | | Change |
|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | YTD'17 vs. YTD'16 |
| | (in thousands, except percentages) | | |
| Interest and other income (expense) | $2,285 | $(44,771) | $47,056 105% |
| As a percentage of revenues | —% | (1)% | |

Interest and other income (expense) increased for the three and six months ended June 30, 2018 primarily due to a foreign exchange gain of $58.1 million and loss of $13.6 million, respectively, compared to losses of $60.7 million and $49.4 million, respectively, for the corresponding periods in 2017. In the three and six months ended June 30, 2018, the foreign exchange gains (losses) were primarily driven by the $85.4 million and $44.3 million, respectively, gains from the remeasurement of our €1,300.0 million Senior Notes, partially offset by the remeasurement of cash and

content liability positions in currencies other than the functional currencies of our European and U.S. entities.

Table of Contents

Provision for (Benefit from) Income Taxes

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | June 30, 2017 | June 30, 2018 | June 30, 2017 |
| | (in thousands, except percentages) | | | |
| Provision for (benefit from) income taxes | $44,287 | $(51,638) | $53,779 | $(6,068) |
| Effective tax rate | 10 % | (370)% | 7 % | (3)% |

The effective tax rate for the three and six months ended June 30, 2018 differed from the Federal statutory rate primarily due to the recognition of excess tax benefits of stock-based compensation and Federal and California research and development credits ("R&D"), partially offset by state taxes, foreign taxes, non-deductible expenses, and the international provisions from the U.S. tax reform enacted in December 2017.

The increase in our effective tax rate for the three and six months ended June 30, 2018, as compared to the same period in 2017 was due primarily to lower benefit on a percentage basis from the recognition of excess tax benefits of stock-based compensation as well as additional expense related to foreign taxes, non-deductible expenses, and the international provisions from the U.S. tax reform enacted in December 2017.

In December 2017, the Tax Cuts and Jobs Act of 2017 (the "Act") was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, the transition of U.S international taxation from a worldwide tax system to a territorial system, and a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017.

On December 22, 2017, Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Act. Additional work is still necessary for a more detailed analysis of our deferred tax assets and liabilities and our historical foreign earnings as well as potential correlative adjustments. Any subsequent adjustment to these amounts will be recorded to current tax expense in the quarter of 2018 when the analysis is complete.

Liquidity and Capital Resources

| | As of | |
|---|---|---|
| | June 30, 2018 | December 31, 2017 |
| | (in thousands) | |
| Cash, cash equivalents and restricted cash | $3,913,994 | 2,822,795 |
| Long-term debt | 8,342,067 | 6,499,432 |

Cash, cash equivalents and restricted cash increased $1,091.2 million in the six months ended June 30, 2018 primarily due to the issuance of debt, partially offset by cash used in operations.

Long-term debt, net of debt issuance costs, increased $1,842.6 million due to the issuance of debt in April 2018, partially offset by the remeasurement of our euro denominated notes. The earliest maturity date for our outstanding long-term debt is February 2021. As of June 30, 2018, no amounts had been borrowed under the $500.0 million Revolving Credit Agreement. See Note 5 Long-term Debt in the accompanying notes to our consolidated financial statements. We anticipate continuing to finance our future capital needs in the debt market, as we continue to believe that our after-tax cost of debt is lower than our cost of equity. 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.

Our primary uses of cash include the acquisition, licensing and production of content, streaming delivery, marketing programs and personnel-related costs. Cash payment terms for non-original content have historically been in line with the amortization period. Investments in original content, and in particular content that we produce and own, require more cash upfront relative to licensed content. For example,

Table of Contents

production costs are paid as the content is created, well in advance of when the content is available on the service and amortized. We expect to continue to significantly increase our investments in global streaming content, particularly in original content, which will impact our liquidity and result in future negative free cash flows for many years. We currently anticipate that cash flows from operations, available funds and access to financing sources, including our revolving credit facility, will continue to be sufficient to meet our cash needs for at least the next twelve months.

Free Cash Flow

We define free cash flow as cash provided by (used in) 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 or the amount of cash used in operations, including investments in global streaming content. 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 used in 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 amortization, non-cash stock-based compensation expense and other working capital differences. 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.

Three months ended June 30, 2018 as compared to the three months ended June 30, 2017

| | Three Months Ended | |
|---|---|---|
| | June 30, 2018 | June 30, 2017 |
| | (in thousands) | |
| Net cash used in operating activities | $(518,239) | $(534,528) |
| Net cash used in investing activities | (40,316) | (56,432) |
| Net cash provided by financing activities | 1,909,412 | 1,420,386 |
| | | |
| Non-GAAP free cash flow reconciliation: | | |
| Net cash used in operating activities | (518,239) | (534,528) |
| Acquisition of DVD content assets | (12,552) | (7,624) |
| Purchases of property and equipment | (27,323) | (65,231) |
| Change in other assets | (441) | (1,064) |
| Non-GAAP free cash flow | $(558,555) | $(608,447) |

Net cash used in operating activities decreased $16.3 million to $518.2 million for the three months ended June 30, 2018. The decreased use of cash was primarily driven by a $1,121.8 million or 40% increase in revenues partially offset by the increase in investments in streaming content that require more upfront payments. The payments for streaming content assets increased $595.7 million, from $2,149.5 million to $2,745.2 million, or 28% as compared to the increase in the amortization of streaming content assets of $267.0 million, from $1,550.8 million to $1,817.8 million, or 17%. In addition, we had increased payments associated with higher operating expenses, primarily related to increased headcount to support our continued improvements in our streaming service, our international expansion and increased content production activities.

Net cash used in investing activities decreased $16.1 million for the three months ended June 30, 2018, primarily due to a $37.9 million decrease in purchases of property and equipment for our Los Gatos and Los Angeles headquarter offices partially offset by a $17.5 million decrease in the proceeds from the sale and maturities of short-term investments, net of purchases.

Net cash provided by financing activities increased $489.0 million for the three months ended June 30, 2018, due to an increase in the proceeds from the issuance of debt from $1,405.5 million, net of $15.0 million issuance costs in the three months ended June 30, 2017, to $1,883.0 million, net of $17.0 million issuance costs in the three months ended June 30, 2018.

Non-GAAP free cash flow was $942.9 million lower than net income for the three months ended June 30, 2018 primarily due to $927.4 million of cash payments for streaming content assets over streaming amortization expense and $96.7 million in other non-favorable working capital differences partially offset by $81.2 million of non-cash stock-based compensation expense.

Table of Contents

Non-GAAP free cash flow was $674.0 million lower than net income for the three months ended June 30, 2017, primarily due to $598.7 million of cash payments for streaming content assets over streaming amortization expense coupled with $119.3 million of non-favorable other working capital differences partially offset by $44.0 million of non-cash stock-based compensation expense.

Six months ended June 30, 2018 as compared to the six months ended June 30, 2017

| | Six Months Ended | |
|---|---|---|
| | June 30, 2018 | June 30, 2017 |
| | (in thousands) | |
| Net cash used in operating activities | $(754,996) | $(878,384) |
| Net cash provided by investing activities | (90,068) | (132,022) |
| Net cash provided by financing activities | 1,965,426 | 1,444,625 |
| | | |
| Non-GAAP free cash flow reconciliation: | | |
| Net cash used in operating activities | (754,996) | (878,384) |
| Acquisition of DVD content assets | (23,348) | (32,996) |
| Purchases of property and equipment | (64,493) | (117,754) |
| Change in other assets | (2,227) | (1,833) |
| Non-GAAP free cash flow | $(845,064) | $(1,030,967) |

Net cash used in operating activities decreased $123.4 million to $755.0 million for the six months ended June 30, 2018. The decreased use of cash was primarily driven by a $2,186 million or 40% increase in revenues partially offset by the increase in investments in streaming content that require more upfront payments. The payments for streaming content assets increased $1,221.2 million, from $4,131.9 million to $5,353.1 million, or 30% as compared to the increase in the amortization of streaming content assets of $710.2 million, from $2,856.5 million to $3,566.7 million, or 25%. In addition, we had increased payments associated with higher operating expenses, primarily related to increased headcount to support our continued improvements in our streaming service, our international expansion and increased content production activities.

Net cash used in investing activities decreased $42.0 million for the six months ended June 30, 2018, primarily due to a $53.3 million decrease in purchases of property and equipment for our Los Gatos and Los Angeles headquarter offices and a $9.6 million decrease in the acquisition of DVD content assets partially offset by a $20.6 million decrease in the proceeds from the sales and maturities of short-term investments, net of purchases.

Net cash provided by financing activities increased $520.8 million in the six months ended June 30, 2018, due to the proceeds from the issuance of debt of $1,883.0 million, net of $17.0 million of issuance costs.

Free cash flow was $1,519.5 million lower than net income for the six months ended June 30, 2018 primarily due to $1,786.4 million of cash payments for streaming content assets over streaming amortization expense partially offset by $117.3 million favorable other working capital differences and $149.6 million of non-cash stock-based compensation expenses.

Free cash flow was $1,274.8 million lower than net income for the six months ended June 30, 2017, primarily due to $1,275.5 million of cash payments for streaming content assets over streaming amortization expense coupled with $88.2 million non-favorable other working capital differences partially offset by $88.9 million of non-cash stock-based compensation expense.

Table of Contents

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 the payment of the obligations discussed below is estimated based on information available to us as of June 30, 2018. 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 as of June 30, 2018:

| | 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) | $18,398,766 | $8,212,614 | $8,374,640 | $1,718,511 | $93,001 |
| Debt (2) | 11,913,822 | 429,942 | 1,347,480 | 1,448,814 | 8,687,586 |
| Lease obligations (3) | 767,143 | 112,448 | 200,235 | 170,159 | 284,301 |
| Other purchase obligations (4) | 841,562 | 560,414 | 212,162 | 54,028 | 14,958 |
| Total | $31,921,293 | $9,315,418 | $10,134,517 | $3,391,512 | $9,079,846 |

(1) As of June 30, 2018, streaming content obligations were comprised of $4.5 billion included in "Current content liabilities" and $3.6 billion of "Non-current content liabilities" on the Consolidated Balance Sheets and $10.3 billion of obligations that are not reflected on the Consolidated Balance Sheets as they did not then meet the criteria for recognition.

Streaming content obligations increased $0.5 billion from $17.9 billion as of December 31, 2017 to $18.4 billion as of June 30, 2018, primarily due to multi-year commitments associated with the continued expansion of our exclusive and original programming.

Streaming content obligations include amounts related to the acquisition, licensing and production of streaming content. An obligation for the production of content includes non-cancelable commitments under creative talent and employment agreements and other production related commitments. An obligation for the acquisition and licensing of content is incurred at the time we enter into an agreement to obtain future titles. Once a title becomes available, a content liability is 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. Traditional film output deals, or certain TV series license agreements where the number of seasons to be aired is unknown, are examples of these types of agreements. The contractual obligations table above does not include any estimated obligation for the unknown future titles, payment for which could range from less than one year to more than five years. However, these unknown obligations are expected to be significant and we believe could include approximately $3 billion to $5 billion over the next three years, with the payments for the vast majority of such amounts expected to occur after the next twelve months. The foregoing range is based on considerable management judgments and the actual amounts may differ. Once we know the title that we will receive and the license fees, we include the amount in the contractual obligations table above.

(2) Long-term debt obligations include our Notes consisting of principal and interest payments. See Note 5 to the consolidated financial statements for further details.

(3) Lease obligations include lease financing obligations of $13.2 million related to a portion of our current Los Gatos, California headquarters for which we are the deemed owner for accounting purposes, commitments of $487.8 million for our headquarters in Los Gatos, California, and our office space in Los Angeles, California and other commitments of $266.1 million for facilities under non-cancelable operating leases. These leases have expiration dates varying through approximately 2028.

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

Table of Contents

As of June 30, 2018, we had gross unrecognized tax benefits of $56.1 million which was classified in “Other non-current liabilities” and a reduction to deferred tax assets which was classified as "Other non-current assets" in the consolidated balance sheets. At this time, an estimate of the range of reasonably possible adjustments to the balance of unrecognized tax benefits cannot be made.

Off-Balance Sheet Arrangements

We do not have 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.

Indemnification

The information set forth under Note 6 to the consolidated financial statements under the caption “Indemnification” 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 consolidated 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.

Streaming Content

We acquire, license and produce content, including original programing, in order to offer our members unlimited viewing of TV shows and films. The content licenses are for a fixed fee and specific windows of availability. Payment terms for certain content licenses and the production of content require more upfront cash payments relative to the amortization expense. Payments for content, including additions to streaming assets and the changes in related liabilities, are classified within "Net cash used in operating activities" on the Consolidated Statements of Cash Flows.

For licenses, we capitalize the fee per title and record a corresponding liability at the gross amount of the liability 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 assets, net” and the remaining portion as “Non-current content assets, net” on the Consolidated Balance Sheets.

For productions, we capitalize costs associated with the production, including development cost, direct costs and production overhead. We include these amounts in "Non-current content assets, net" on the Consolidated Balance Sheets. Participations and residuals are expensed in line with the amortization of production costs.

Based on factors including historical and estimated viewing patterns, we amortize the content assets (licensed and produced) in “Cost of revenues” on the Consolidated Statements of Operations, over the shorter of each title's contractual window of availability or estimated period of use or ten years, beginning with the month of first availability. The amortization is on an accelerated basis as we typically expect more upfront viewing, for instance due to additional merchandising and marketing efforts. We review factors that impact the amortization of the content assets on a regular basis. Our estimates related to these factors require considerable management judgment.

Our business model is subscription based as opposed to a model generating revenues at a specific title level. Therefore, content assets, both licensed and produced, are reviewed in aggregate at the operating segment level when an event or change in circumstances indicates a change in the expected usefulness. To date, we have not identified any such event or changes in circumstances. If such changes are identified in the future, these aggregated content assets

will be stated at the lower of unamortized cost, net realizable value or fair value. In addition, unamortized costs for assets that have been, or are expected to be, abandoned are written off.

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

Table of Contents

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 likely than not that most of the deferred tax assets recorded on our Consolidated Balance Sheets will ultimately be realized. We record a valuation allowance to reduce our deferred tax assets to the net amount that we believe is more likely than not to be realized. As of June 30, 2018, the valuation allowance of $103.4 million was related to foreign tax credits that we are not expected to realize.

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 June 30, 2018, our estimated gross unrecognized tax benefits were $56.1 million of which $52.3 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 9 to the consolidated financial statements for further information regarding income taxes.

Recent Accounting Pronouncements

The information set forth under Note 1 to the consolidated financial statements under the caption “Basis of Presentation and Summary of Significant Accounting Policies” is incorporated herein by reference.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For financial market risks related to changes in interest rates, reference is made to Item 7A “Quantitative and Qualitative Disclosures About Market Risk” contained in Part II of our Annual Report on Form 10-K/A for the year ended December 31, 2017. Our exposure to market risk has not changed significantly since December 31, 2017.

Foreign Currency Risk

International revenues and cost of revenues account for 49% and 58%, respectively, of consolidated amounts for the six months ended June 30, 2018. The majority of international revenues and a smaller portion of expenses are denominated in currencies other than the U.S. dollar and we therefore have foreign currency risk related to these currencies, which are primarily the euro, the British pound, the Canadian dollar, the Australian dollar, the Japanese yen, the Argentine Peso and the Brazilian real.

Accordingly, changes in exchange rates, and in particular a weakening of foreign currencies relative to the U.S. dollar may negatively affect our revenue and contribution profit (loss) of our International streaming segment as expressed in U.S. dollars. In the six months ended June 30, 2018, we believe our international revenues would have been approximately $179.3 million lower had foreign currency exchange rates remained consistent with those in same period of 2017.

We have also experienced and will continue to experience fluctuations in our net income as a result of gains (losses) on the settlement and the remeasurement of monetary assets and liabilities denominated in currencies that are not the functional currency. In the six months ended June 30, 2018, we recognized a $58.1 million foreign exchange gain which resulted primarily from the remeasurement of our €1,300.0 million Senior Notes and the remeasurement of cash and content liability positions in currencies other than the functional currencies of our European and U.S. entities.

In addition, the effect of exchange rate changes on cash, cash equivalents and restricted cash as disclosed on the Consolidated Statements of Cash Flow for the six months ended June 30, 2018 was $(36.3) million.

We do not use foreign exchange contracts or derivatives to hedge any foreign currency exposures. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. 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 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under Note 6 in the notes to the consolidated financial statements under the caption “Legal Proceedings” is incorporated herein by reference.

Table of Contents

Item 1A. Risk Factors

There have been no material changes from the risk factors as previously disclosed under the heading “Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Item 6. Exhibits

(a) Exhibits:

See Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q.

Table of Contents

SIGNATURES

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

NETFLIX, INC.

Dated: July 18, 2018 By:

Reed Hastings
Chief Executive Officer
(Principal executive officer)

Dated: July 18, 2018 By:

David Wells
Chief Financial Officer
(Principal financial and accounting officer)

Table of Contents

EXHIBIT INDEX

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | | Filed Herewith |
|---|---|---|---|---|---|---|
| | | Form | File No. | Exhibit | Filing Date | |
| 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 Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 filed with the SEC on July 18, 2018, formatted in XBRL includes: (i) Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2018 and 2017, (ii) Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2018 and 2017 (iii) Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017, (iv) Consolidated Statements of Cash Flows for the Three and Six Months Ended June 30, 2018 and 2017 and (v) the Notes to the Consolidated Financial Statements. | | | | | X |

* 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.