Financial Statement Analysis:

Understand and Interpret Financial Results for Better Management & Credit Decisions

Denver – March 30, 2004

Axiomate

Introduction and Understanding Specific Interests

- **Eric Edwards – Axiomate, Inc.**
- **Jeff Holben – E^2 Business Services, Inc.**

- What Participants Hope to Get from Seminar

Purpose of Class

- Understand the basics of financial presentation
  - Understand where the numbers come from and what they mean.
  - Introduction to the “art of accounting” or the objective v. subjective
- Understand the basics of financial instruments
- Understand the basics of deal evaluation

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Our Day

- Walkthrough the Financial Statements
- Discuss each major line item:
  - What the number means
  - Source of the number
    - Evidentiary matter behind the number
  - Hard side of number
    - The extent to which the number is **OBJECTIVE**
  - Soft side of number
    - The extent to which the number is **SUBJECTIVE**
  - The One Sided Entry
    - For every action (Dr.) there is an equal and opposite reaction (Cr.)
- Look at footnotes
- Walk through the S-1
- Turn you lose on the numbers, maybe

Types of Org. Structures

	Proprietorship	Partnership	**S-Corp**	**LLC**	**Corp**
Participants	Only One	2 or More	**< 75 & No Corps**	**No Limit**	**No Limit**
Taxes	At Personal Levels	Pass Through to Owners	**Pass Through**	**Pass Through**	**34%**
Distributions	No double tax	No double tax	**No double tax**	**No double tax**	**Taxed to shrhldrs**
Life	Ends Upon Death	Into Estate Upon Death	**No Limit**	**Varies by State**	**No Limit**

What Type of Org. Structure

- Number of Owners/Shareholders
- Taxes
- Liability
- Cost of Operations
- Financing

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Purpose of Financial Statements

- Used by:
  - Equity Shareholders
  - Banks and Financial Creditors
  - Customers and Suppliers
  - Potential Investors
  - Management and Board

Relied upon in gaining comfort from risk

Purpose of Financial Statements

- Equity Shareholders
  - Monitoring Investment & Management
- Banks and Financial Creditors
  - Analyzing Risk For Credit Decisions
- Customers and Suppliers
  - Analyzing Risk For Credit Decisions
- Potential Investors
  - Analyzing Risk for Investment Decision
- Management and Board
  - Business Management / Oversight

Purpose ---

- Comfort from Risk
  - Credit Risk
  - Investment Risk
  - Management Risk
  - Employment Risk
  - Purchase Risk

Purpose of Financial Statements

Offense – Statement preparers

Vs

Defense – Statement Users
(& Auditors)

Example Companies

- Netflix, Inc. (Simpler)
  - Symbol: NFLX (NASDAQ)
  - Total Revenues of $150 million
  - Rapidly growing, entrepreneurial company
- Aspen Technology, Inc. (Complex)
  - Symbol: AZPN (NASDAQ)
  - Total Revenues of $320 million
  - Complex, struggling company
  - *Core Financial Statements do not tell the whole story*

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Guest Company - NetFlix

Netflix (Nasdaq: NFLX) is the world's largest online DVD movie rental service offering more than one million members access to more than 15,000 titles.

Netflix's appeal and success are built on providing the most expansive selection of DVDs, an easy way to choose movies and fast, free delivery.

Elements of A Complete Financial Package

- Auditors Opinion
- Balance Sheet
- Income Statement
- Statement of Cash Flows
- Statement of Equity
- Footnotes
- Other SEC Disclosures for Public Companies

Types of Statements – Accountant Opinions

- Audit
  - Statements are a fair presentment in accordance with GAAP
- Review
  - Statements presented in GAAP, appear fair.
- Compilation
  - Statements have been organized

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Understanding The Auditor's Opinion (the Defense?)

- Only the Opinion Page Belongs to the Auditors (not our job to prepare statements)
- Our work is sufficient to have ***REASONABLE*** assurance statements are free of ***MATERIAL misstatement***
- The Statements prepared on consistent basis and ***Present FAIRLY*** the financial condition
- Qualified vs.. Unqualified

Auditor's Opinion - Unqualified

To Aspen Technology, Inc.:

We have audited the accompanying consolidated balance sheets of Aspen Technology, Inc. (a Delaware corporation) and subsidiaries as of June 30, 2000 and 2001, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss) and cash flows for each of the three years in the period ended June 30, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Aspen Technology, Inc. and subsidiaries as of June 30, 2000 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2001 in conformity with accounting principles generally accepted in the United States.

Auditor's Opinion - Qualified

To the Board of Directors and Stockholders of
Aspen Technology, Inc.:

We have audited the accompanying consolidated balance sheet of Aspen Technology, Inc. and subsidiaries as of June 30, 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit. The financial statements of Aspen Technology, Inc. and subsidiaries as of June 30, 2001 and for each of the two years in the period then ended were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated August 3, 2001.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Aspen Technology, Inc. and subsidiaries as of June 30, 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Qualification

As discussed above, the financial statements of Aspen Technology, Inc. and subsidiaries as of June 30, 2001 and for the year then ended were audited by other auditors who have ceased operations. As described in Note 2(p), those financial statements have been reclassified to reflect reimbursements from customers for "Out-of-Pocket" expenses incurred as revenue rather than as a reduction of expenses. We audited the adjustments described in Note 2(p) that were applied to reclassify the 2001 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2001 financial statements of the Company other than with respect to such adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2001 financial statements taken as a whole.

Auditors – who do they play for?

- Auditors were established as somewhat of a private sector police force to uphold accounting integrity.
  - Securities Act of 1933/34
- Auditors perform the ***"ATTEST"*** function
  - They assume responsibility for fairness & dependability
- Yet, auditors are hired by and paid for by the Company
  - Audit committee (Mgmt Control vs.. Independent)
- Through 2000, consulting fees were lucrative

Understanding Company's Motivates (the Offense)

- Financial statements and footnotes belong to the company.
- Management uses financial statements to tell a story – the way they want to story to be told.
- Story may be designed for a specific audience.
  - Consider who the audience might be when reading statements
- Financial statement presentation is NOT black & white.

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Dissecting The Balance Sheet

ASSETS

Fundamentals of Accounting

For every debit, there must be an equal and corresponding credit(s)

Cash

Dr.	Cr.
$ 100.00	

?

Dr.	Cr.
	$ 100.00

The Balance Sheet

Liquidity

Current Assets

Fixed Assets

Other Assets

Assets	2001	2002
Current assets:		
Cash and cash equivalents	$ 16,131	$ 59,814
Short-term investments	—	43,796
Prepaid expenses	1,019	2,753
Prepaid revenue sharing expenses	732	303
Other current assets	1,670	409
Total current assets	$ **19,552**	**107,075**
Fixed assets:		
DVD library, net	3,633	9,972
Intangible assets, net	7,917	6,094
Property and equipment, net	8,205	5,620
Other assets:		
Deposits	1,677	1,690
Other assets	646	79
Total assets	$ **41,630**	$ **130,530**

Current Liabilities

Long-Term Liabilities

Equity Section

Liabilities and Stockholders' (Deficit) Equity	2001	2002
Current liabilities:		
Accounts payable	$ 13,715	$ 20,350
Accrued expenses	4,544	9,102
Deferred revenue	4,937	9,743
Current portion of capital lease obligations	1,345	1,231
Notes payable	1,667	—
Total current liabilities	$ **26,208**	$ **40,426**
Deferred rent	240	288
Capital lease obligations, less current portion	1,057	460
Subordinated notes payable, net of unamortized discount of $10,851 at December 31, 2001	2,799	—
Total liabilities	$ **30,304**	$ **41,174**
Commitments and contingencies (note 5)		
Redeemable convertible preferred stock	101,830	
Stockholders' (deficit) equity:		
Convertible preferred stock, $0.001 par value; 8,500,000 and 10,000,000 shares authorized at December 31, 2001 and 2002, respectively; 6,157,499 and no shares issued and outstanding at December 31, 2001 and 2002, respectively; aggregate liquidation preference of $2,222 at December 31, 2001	6	—
Common stock, $0.001 par value; 100,000,000 and 150,000,000 shares authorized at December 31, 2001 and 2002, respectively; 2,161,855 and 22,445,795 issued and outstanding at December 31, 2001 and 2002, respectively	2	22
Additional paid-in capital	52,479	259,172
Deferred stock-based compensation	(5,275)	(11,399)
Accumulated other comprehensive income	—	774
Accumulated deficit	(137,266)	(159,213)
Total stockholders' (deficit) equity	$ **(90,504)**	$ **89,356**
Total liabilities and stockholders' (deficit) equity	$ **41,630**	$ **130,530**

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The Balance Sheet – Current Assets

Assets	As of December 31, 2001		As of December 31, 2002	
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Also: A/R & Inv

Dissecting the Balance Sheet – Left Side Thinking – Current Assets

Current Assets

	What	Source of Numbers
Cash	Book balance in bank accounts	The "CheckBook"
Accounts Receivable	List of who owes us	Sales less cash receipts
Inventory	What is in the warehouse	Purchases less cost of goods
Prepaid Expenses	What have we paid in advance	Occassional dr/cr usually coded from A/P

Dissecting the Balance Sheet – Left Side Thinking – Current Assets

Current Assets

	Hardside	Softside
Cash	Bank Statements/Reconcilation	
Accounts Receivable	A/R Ledger	Bad debt allowance; failure to recognize the inevitable
Inventory	Inventory Register	Obsolensce Allowances, slow-moving product, valuation methods(flow assumptions)
Prepaid Expenses		Amortization methods; validity

The Balance Sheet – Fixed Assets

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Fixed assets:

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Axiomate, Inc.

Fixed Assets (Aspen Tech)

ASSETS	June 30, 2001	June 30, 2002
Long-term installments receivable, net of unamortized discount of $8,437 in 2001 and $12,990 in 2002	43,428	68,318
Property and leasehold improvements, at cost:		
Building and improvements	4,639	2,241
Computer equipment	45,465	48,184
Purchased software	38,498	55,621
Furniture and fixtures	16,090	17,552
Leasehold improvements	8,243	10,078
	112,935	133,676
Less — Accumulated depreciation and amortization	69,659	82,873
	43,276	50,803
Computer software development costs, net of accumulated amortization of $16,091 in 2001 and $20,804 in 2002	8,539	13,810
Purchased intellectual property, net of accumulated amortization of $1,974 in 2002	—	27,626
Other intangible assets, net of accumulated amortization of $9,970 in 2001 and $15,232 in 2002	19,612	41,105
Goodwill	24,352	84,258
Deferred tax asset	15,686	15,576
Other assets	15,737	6,708
	$ 406,594	$ 548,343

Dissecting the Balance Sheet – Left Side Thinking – Fixed Assets

	What	Source of Numbers
Land	Price paid for any land owned	Purchase price
Plant	Cost of building or buying building	Purchase Price / Capital Project Ledger
Equipment	Cost of acquisition	Purchase price
Computer Systems	Cost of acquisition	Purchase price
Furniture & Fixtures	Cost of acquisition	Purchase Price
Leasehold Improvements	Cost of improvements	
Other	Usually Cost	
Depreciation	ESTIMATE of allocation of cost of capital item to business operations	Calculation usually done by accounting system

Dissecting the Balance Sheet – Left Side Thinking – Fixed Assets

	Hardside	Softside
Land	Fixed Asset Ledgers	Booked at historical cost, current value usually much greater
Plant	" "	Capitalization policy
Equipment	" "	Capitalization policy
Computer Systems	" "	Computers obsolescence not usually consistent with depreciation policies
Furniture & Fixtures	" "	Capitalization policy
Leasehold Improvements	" "	Lease Design
Other		
Depreciation	" "	Depreciation Policy - Judgement

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The Balance Sheet – Intangibles / Other Assets

Assets		As of December 31, 2001	2002
Current assets:			
Cash and cash equivalents	$	16,131	$ 59,814
Short-term investments		—	43,796
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discount of	2,799	—
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note 5)		
	101,830	
00,000 and 02, respectively; er 31, 2001 and 2002, December 31, 2001	6	—
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	52,479	259,172
	(5,275)	(11,399)
	—	774
	(137,266)	(159,213)
	$ **(90,504)**	$ **89,356**
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Other assets:			
Deposits		1,677	1,690
Other assets		646	79
Total assets	$	**41,630**	$ **130,530**

Creating the Intangible

(what to do with the debit)

Cash	
Dr.	Cr.
	$ 100.00

?	
Dr.	Cr.
$ 100.00	$ -

Dissecting the Balance Sheet – Left Side Thinking – Intangibles

	What	Source of Numbers
Capital Software	Internal costs of product development	Capitalization Ledger
Customer List/Non Competes	Allocation of acquisition purchase price	Purchase & Sale Agreements
Organization Expenses	Early costs of starting business	Expense reports
Goodwill	Premuim paid for a business in excess of its identifiable assets	Excess purchase price over assets acquiired

Dissecting the Balance Sheet – Left Side Thinking – Intangibles

	Hardside	Softside
Capital Software		Capitalization policies, cost allocation methods, amortization methods, impairments
Customer List/Non Competes		Judgement. This is an allocated number. Management will tend to allocate as much to this as possible. Amortization policies
Organization Expenses		Capitalized lunch
Goodwill		A soft number. Impairment. Businesses without Goodwill on books often have Goodwill

Dissecting the Balance Sheet – Left Side Thinking – Other Assets

- Deposits
- Long-term receivables
- Deferred Tax benefits
- Long-term prepaids

Dissecting The Balance Sheet

LIABILITIES

Netflix – Current Liabilities

Assets	As of December 31, 2001	2002
Current assets:		
Cash and cash equivalents	$ 16,131	$ 59,814

Liabilities and Stockholders' (Deficit) Equity	As of December 31, 2001	2002
Current liabilities:		
Accounts payable	$ 13,715	$ 20,350

Liabilities and Stockholders' (Deficit) Equity

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Total liabilities and stockholders' (deficit) equity	**$ 41,630**	**$ 130,530**

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Dissecting the Balance Sheet
Right Side Thinking
Current Liabilities

	What	Source of Numbers
Notes payable	Signed debt instruments due within the year	Cash receipt
Current portion of LT	The amount of prinicipal that must be paid in next tweleve months	Journal entry
Accounts payable	Bills	Purchases and invoices less payments
Accrued expenses	Recognition that amounts are due before invoices are received	Journal entry
Deferred revenue	Cash receipts in advance of earned revenue. Will be revenue within year	Cash receipts (without invoices)
Taxes payable	Amounts due to taxing authorities	Journal entry from tax return, payroll ledger less payments

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Dissecting the Balance Sheet
Right Side Thinking
Current Liabilities

	Hardside	Softside
Notes payable	Full balance of a demand or short-term note	
Current portion of LT	Amortization schedule of a note	Conditions could be such that more of note is due than set forth... "skimming bounds of covenants"
Accounts payable	Accounts Payable Ledger / Trial Balance	
Accrued expenses	NONE	Unallocated accruals or insufficient accruals
Deferred revenue	List / informal subledger	Balance represents future sale (with profit - see Deferred Expense)
Taxes payable	Tax return, payroll register	

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Netflix – Long Term Liabilities

Assets		As of December 31, 2001		2002
Current assets:				
Cash and cash equivalents	$	16,131	$	59,814
Short-term investments		—		43,796
Prepaid expenses		1,019		2,753
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Tot				
Fix				
DV				
Inta				
Pro				
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Notes payable		1,667		—
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Capital lease obligations, less current portion		1,057		460
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Total liabilities	$	**30,304**	$	**41,174**
Commitments and contingencies (note 5)				
Redeemable convertible preferred stock		101,830		

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Dissecting the Balance Sheet – Right Side Thinking
Long-Term Liabilities

	What	Source of Numbers
Long term debt	The amount of principal from long term debt NOT due within next tweleve months	Journal entry
Deferred taxes	Amounts recorded on books for taxes, not really due in current period	Calculation of tax accrual
Convertible Debt	A quasi-equity issue that may be paid in cash or may be turned into equity	Journal entry
Commitments & Contingencies	Entry to balance sheet that warns you to read footnotes	NO NUMBER

Dissecting the Balance Sheet – Right Side Thinking

Long-Term Liabilities

	Hardside	Softside
Long term debt	Amortization schedule of a note	Conditions could be such that more of note is due than set forth... "skimming bounds of covenants"
Deferred taxes		A soft calculation subject to changes from future events. Generally, little cash consequence. The 2nd set of books.
Convertible Debt	Fixed amount due	Interpretation as to liklihood this becomes equity. May have provisions that change value in certain circumstances
Commitments & Contingencies	NONE	READ footnotes carefully

Dissecting The Balance Sheet

EQUITY / NET WORTH

Netflix – Equity

Assets	As of December 31, 2001	2002	Liabilities and Stockholders' (Deficit) Equity	As of December 31, 2001	2002
Current assets:			**Current liabilities:**		
Cash and cash equivalents	$ 16,131	$ 59,814	Accounts payable	$ 13,715	$ 20,350
Short-term investments	—	43,796	Accrued expenses	4,544	9,102
Total assets	$ 41,630	$ 130,530	**Total liabilities and stockholders' (deficit) equity**	$ 41,630	$ 130,530

Stockholders' (deficit) equity:

	2001	2002
Convertible preferred stock, $0.001 par value; 8,500,000 and 10,000,000 shares authorized at December 31, 2001 and 2002, respectively; 6,157,499 and no shares issued and outstanding at December 31, 2001 and 2002, respectively; aggregate liquidation preference of $2,222 at December 31, 2001	6	—
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Dissecting the Balance Sheet
Right Side Thinking
Equity

	What	Source of Numbers
Common Stock	Shares Out * Par Value	Cash In - Journal Entry
Preferred Stock	Shares Out * Par Value	Cash In - Journal Entry
APIC	Cash Rec'd for Investment less (Shares out * Par Value)	Cash In - Journal Entry
Treasury Stock	Cash Paid to Repurchase Stock	Cash Out - Journal Entry
Retained Earnings	Cumulative Net Income History	Previous Period Retained Earnings plus Current Income
Foreign Exchange Adj	Changes in NW caused by foreign currency changes	Calculation
Other	Stock based compensation	Calculation

Dissecting the Balance Sheet
Right Side Thinking
Equity

	Hardside	Softside
Common Stock	Stock Register	Consideration Paid, Non-Cash, etc.
Preferred Stock	Stock Register	Consideration Paid, Non-Cash, etc.
APIC	Stock Register	Consideration Paid, Non-Cash, etc.
Treasury Stock	Stock Register	Alternative Methods for Calc
Retained Earnings	Income Statements	Alternative Presentations; Occasional Direct Entries, see Retained Earning Rollforward Calculation
Foreign Exchange Adj		
Other		Calculation

Watch stock for …..

Complex Equity (Aspen Tech)

	June 30, 2001	June 30, 2002
LIABILITIES AND STOCKHOLDERS' EQUITY		
Stockholders' equity:		
Series B convertible preferred stock, $0.10 par value — Authorized — 60,000 shares		
Issued and outstanding — 60,000 shares in 2002 (Liquidation preference of $60,860)	—	50,753
Common stock, $0.10 par value — Authorized — 40,000,000 shares		
Issued — 31,576,924 shares in 2001 and 37,731,183 shares in 2002 Outstanding — 31,346,494 shares in 2001 and 37,500,753 shares in 2002	3,157	3,773
Additional paid-in capital	228,976	310,039
Accumulated deficit	(24,127)	(107,593)
Deferred compensation	(1,400)	—
Notes receivable from stockholders	(283)	—
Treasury stock, at cost — 230,430 shares of common stock	(502)	(502)
Accumulated other comprehensive income (loss)	(4,751)	(2,682)
Total stockholders' equity	201,070	253,788

Dissecting the Balance Sheet – Important Metrics

Current Ratio	Current Assets	/	Current Liabilities	General liquidity	$ 107,075	/	$ 40,426	**2.65**
Quick Ratio	(Cash + AR)	/	Current Liabilities	Ability to meet debt with existing resources	$ 103,610	/	$ 40,426	**2.56**
Debt/Equity	current Liabilites + Long Term Liabilities	/	Share Holder Equity	Leverage (Owned vs. Owed)	$ 41,174	/	$130,530	**0.32**
EBITDA	Earnings	+	(Int/Tax/Dep/ Amort)	Crude measure of cash flow	$ (21,967)	+	$ 36,772	**$ 14,805**
Bad debt reserve *	Allowance for doubtful accounts	/	AR + Allowance	Magnitude of collection issues, particularly in comparison	$ 1,500	/	$ 28,500	**5.3%**
Debt Coverage	EBITDA	/	Debt Service	Company's ability to cover its obligations	$ 14,805	/	$ 1,511	**9.80**
Free Cash	EBITDA	-	Debt Service	What is true cash flow for business	14,805	-	$ 1,511	**$ 13,294**

Axiomate

Dissecting the Balance Sheet – Other Good Metrics

- Inventory Turnover:
  - Cost of Goods/Inventory
  - Inventory turnover days: 365/Inventory Turnover
- A/R Turnover
  - Sales/Accounts Receivable
  - A/R turnover days: 365 / AR Turnover
- Cash Cycle
  - Add Inventory and A/R days
  - Number of days from product to cash

Dissecting The Income Statement

Income Statement – Revenue – Growth

	Year Ended December 31,		
	2000	2001	2002
Revenues:			
Subscription	$ 35,894	$ 74,255	$ 150,818
Sales	—	1,657	1,988
Total revenues	$ 35,894	$ 75,912	$ 152,806

	Year Ended December 31,		
	2000	**2001**	**2002**
Revenues:			
Subscription	$ 35,894	$ 74,255	$ 150,818
Sales	—	1,657	1,988
Total revenues	**$ 35,894**	**$ 75,912**	**$ 152,806**

	2000	2001	2002
Restructuring charges		671	
Stock-based compensation *	8,803	5,686	9,831
Total operating expenses	**$ 68,590**	**$ 63,232**	**$ 86,342**
Operating loss	**$ (57,557)**	**$ (37,227))**	**$ (11,672)**
Other income (expense):			
Interest and other income	1,645	461	1,697
Interest and other expense	(1,451)	(1,852)	(11,992)
Net loss	**$ (57,363)**	**$ (38,618)**	**$ (21,967)**
Net loss per share:			
Basic and diluted	$ (40.57)	$ (21.15)	$ $ (1.56)
Weighted average shares outstanding:			
Basic and diluted	1,414	1,826	14,102

Income Statement – Revenue - Transition

	Years Ended June 30,		
	2000	2001	2002
	(In thousands, except per share data)		
Revenues:			
Software licenses	$ 132,843	$ 147,448	$ 133,913
Service and other	135,250	179,476	186,691
Total Revenue	268,093	326,924	320,604

Growth

No Growth

Dissecting the Income Statement - Revenue

- Types of Revenues
  - Goods Sold (Sales)
  - Fees
  - Subscriptions
  - Rents
  - Software Licenses
  - Maintenance
- Gross vs.. Net
- Project Revenues / Progress Billing
- When to Recognize / Record

Income Statement – Revenue – Growth

	Year Ended December 31, 2000	2001	2002
Revenues:			
Subscription	$ 35,894	$ 74,255	$ 150,818
Sales	—	1,657	1,988

	Year Ended December 31, 2000	2001	2002
Revenues:			
Subscription	$ 35,894	$ 74,255	$ 150,818
Sales	—	1,657	1,988
Total revenues	**$ 35,894**	**$ 75,912**	**$ 152,806**
Cost of revenues:			
Subscription	24,861	49,088	77,044
Sales	—	819	1,092
Total cost of revenues	**$ 24,861**	**$ 49,907**	**$ 78,136**
Gross profit	**$ 11,033**	**$ 26,005**	**$ 74,670**

Weighted average shares outstanding:			
Basic and diluted	1,414	1,826	14,102

Axiomate

Axiomate, Inc.

Dissecting the Income Statement – Cost of Goods

	2000	2001	2002
		Years Ended June 30, (In thousands, except per share data)	
Expenses:			
Cost of software licenses	9,605	11,856	11,830
Cost of service and other	85,193	114,595	119,972
Selling and marketing	91,863	113,608	115,225
Research and development	51,567	68,913	74,458
General and administrative	24,736	30,643	34,258
Costs related to acquisitions	1,547	—	—
Restructuring and other charges	—	6,969	16,083
Charges for in-process research and development	—	9,915	14,900
	264,511	356,499	386,726
Income (loss) from operations	3,582	(29,575)	(66,122)
Interest income	9,847	10,268	6,768
Interest expense	(5,563)	(5,469)	(5,591)
Write-off of investments	—	(5,000)	(8,923)
Foreign currency exchange loss	(118)	(81)	(1,073)
Income on equity in joint ventures and realized gain on sale of investments	4	750	180
Income (loss) before provision for (benefit from) income taxes	7,752	(29,107)	(74,761)
Provision for (benefit from) income taxes	2,324	(8,732)	2,404
Net income (loss)	5,428	(20,375)	(77,165)

Dissecting the Income Statement – Cost of Goods

- Direct Cost of Revenue
- Cost of Sales vs.. Operating Expenses
- Should Cost of Sales all be variable?
- Allocation of Fixed Expenses to departments/categories

Axiomate

Aspen Tech – Operating Expenses

	Years Ended June 30,		
	2000	2001	2002
	(In thousands, except per share data)		
Expenses:			
Cost of software licenses	9,605	11,856	11,830
Cost of service and other	85,193	114,595	119,972
Selling and marketing	91,863	113,608	115,225
Research and development	51,567	68,913	74,458
General and administrative	24,736	30,643	34,258
Costs related to acquisitions	1,547	—	—
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Provision for (benefit from) income taxes	2,324	(8,732)	2,404
Net income (loss)	5,428	(20,375)	(77,165)

Dissecting the Income Statement – Operating Expenses

- Types of Expenses – Allocation Discretion
- Sales and Marketing
  - Advertising, Sales salaries/commissions, T&E
- Research & Development
  - Development Salaries
- General & Administrative
  - Rent, Supplies, Utilities
- Other Operating Expenses / Non-recurring / Special
- Cash vs.. Non-Cash
- Capitalized Expenses / Amortization

Axiomate

Operating expense – another approach

	2003	Operations	R&D	S&M	G&A
Revenue	**$2,384,272**				
Direct Cost of Sales:					
Royalties	17,878				
Rebillable expenses	12,655				
Other direct cost of sales	27,345				
	57,878				
Gross Margin	**2,326,394**				
Operating Expenses:					
Salaries	1,141,304	456,522	171,196	285,326	228,261
Commissions	88,450	35,380	13,268	22,113	17,690
Benefits	236,694	94,678	35,504	59,174	47,339
Travel	20,450	8,180	3,068	5,113	4,090
Meetings, training	289	116	43	72	58
Recruiting	1,578	631	237	395	316
Contract labor	169,900	67,960	25,485	42,475	33,980
Legal & accounting fees	28,500	11,400	4,275	7,125	5,700
Advertising, mkting materia	35,000	14,000	5,250	8,750	7,000
Equip. maintenance, leasir	22,956	9,182	3,443	5,739	4,591
Rent	105,649	42,260	15,847	26,412	21,130
Bldg. repairs, maintenance	15,261	6,104	2,289	3,815	3,052
Insurance	7,625	3,050	1,144	1,906	1,525
Postage & Freight	5,185	2,074	778	1,296	1,037
Production Materials	598	239	90	150	120
Supplies	10,903	4,361	1,635	2,726	2,181
Taxes	2,281	912	342	570	456
Telephone	25,278	10,111	3,792	6,320	5,056
Dues & subscriptions	2,494	998	374	624	499
Bad debts	3,000	1,200	450	750	600
Total Operating Expen	**1,923,395**	**769,358**	**288,509**	**480,849**	**384,679**
Net Operating Income	**428,170**				
Extraordinary Operating Ex	27,957				
EBITDA	**400,213**				
Deprec. & Amortization	236,695				
EBIT	**163,518**				
Other Income	2,752				
Interest Expense	187,088				
Net Income Before Income Taxes	**($20,818)**				

Axiomate

Dissecting the Income Statement – Below the Line

- Interest & Investment Income / (Expense)
- Extraordinary Items
- Minority Interest
- New Reconciliations

Dissecting the Income Statement – Important Metrics & Terms

- Gross Margin / Contribution Margin
- Operating Margin / Return of Sales
- Industry Specific Measures
    - Sales & Marketing / Revenues
    - R&D / Revenues
    - G&A / Revenues
- EBITDA

Aspen Tech
Comparative Income Statement

	Fiscal year ending June 30,				
Actual Results	**1998**	**1999**	**2000**	**2001**	**2002**
Revenue	252.6	226.6	268.1	326.9	320.6
Cost Of Revenue	76.7	91.8	94.8	126.4	131.8
Gross Margin	**175.9**	**134.8**	**173.3**	**200.5**	**188.8**
	69.6%	59.5%	64.6%	61.3%	58.9%
Selling and Marketing	74.9	85.7	91.9	113.6	115.2
Research and Development	43.6	48.6	51.6	68.9	74.5
General and Admin	20.2	23.5	24.7	30.6	34.2
OPEX from continuing ops	**138.7**	**157.8**	**168.2**	**213.1**	**223.9**
Income from continuing ops	**37.2**	**(23.0)**	**5.1**	**(12.6)**	**(35.1)**
Other/One Time Charges	13.5	17.9	1.5	16.9	31.0
Operating Income	**23.7**	**(40.9)**	**3.6**	**(29.5)**	**(66.1)**

Aspen Tech
Income Statement Trend Analysis

	Fiscal year ending June 30,				
Actual Results	**1998**	**1999**	**2000**	**2001**	**2002**
Revenue	252.6	226.6	268.1	326.9	320.6
Cost Of Revenue	76.7	91.8	94.8	126.4	131.8
Gross Margin	175.9	134.8	173.3	200.5	188.8
Selling and Marketing					
Research and Development					
General and Admin					
OPEX from continuing ops					
Income from continuing ops					
Other/One Time Charges					
Operating Income					

Actual Results	**1998**	**1999**	**2000**	**2001**	**2002**
EBITDA Calculation					
Income from continuing	37.2	(23.0)	5.1	(12.6)	(35.1)
Depr / Amort	16.0	16.0	16.0	16.0	16.0
EBITDA - continuing	***53.2***	***(7.0)***	***21.1***	***3.4***	***(19.1)***

Expense as a % of Revenue	**1998**	**1999**	**2000**	**2001**	**2002**
Selling and Marketing	30%	38%	34%	35%	36%
Research and Development	17%	21%	19%	21%	23%
General and Admin	8%	10%	9%	9%	11%
Other/One Time Charges	5%	8%	1%	5%	10%
Total	0%	0%	0%	0%	0%

Employees	1518	1448	1731	1927	1927
Selling/Marketing per Employe	49,341	59,185	53,091	58,952	59,782
Revenue per Employee	166,403	156,492	154,882	169,642	166,373

Axiomate

Taking a Bath

- What companies / CFO's will do in bad years
  - Positioning to manage earnings in good years
  - Sometimes, they will "profit" from the bathwater
  - Many washed up in 2001/02

Dissecting The Statement of Cash Flows

Axiomate

What is Cash?

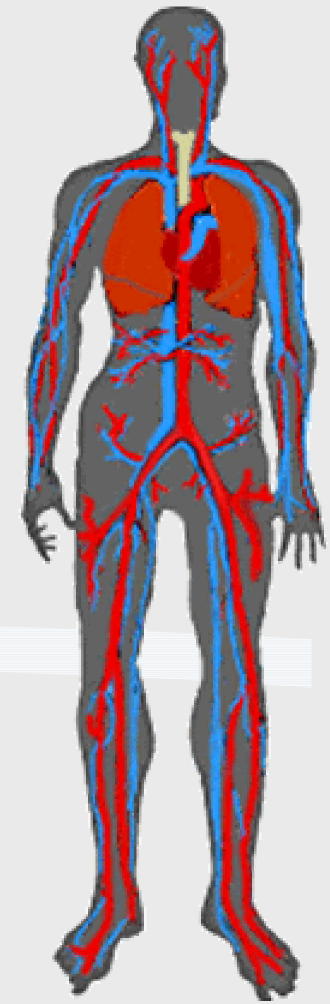
- Cash is the money that a person actually has, including money on deposit (Webster's)
- Cash is the medium of exchange (Economics)
- Cash is king (am. slang)

Axiomate

Cash is……

The lifeblood of a business. It nourishes all of the arms of an organization. It keeps it alive!

(Revenue, is the heart in this body. It is revenue that must continually pump the cash into and through the system.)



Axiomate

Cash consists of

- Money on hand (petty cash or cash in the vault)
- Cash in the bank
  - Deposits in transit (but not O/S checks)
- Cash equivalents
  - Time deposits
  - Repos
  - Other

Axiomate

Cash does not consist of:

- Short-term Investments
  - Near enough to cash (see footnotes)
- Long-term Investments
- Accounts Receivable
- Deposits

What is cash flow?

- Cash that is generated by a business
  - Generally customers
- Vs. that is demanded by the business:
  - including its shareholders,
  - financiers
  - and vendors
- in its normal course.

Cash comes from:

- **Operations or Operating Activities**
  - Sales, usually via accounts receivable (see sources and uses.)
- **Investing Activities**
  - Sale of part of the business
  - Sale of assets (including factoring)
- **Financing Activities**
  - Investors (sale of stock)
  - Banks (Loans)

Cash v. Cash Flow and Income

- I made money, but I feel so broke
  - Timing differences between net income and cash
    - Receivables vs.. payables
    - Deferred expenses vs.. revenues
    - Capital expenditures and amortization
    - Growth financing
- You say I lost money, ha! I have plenty of cash
    - For now! There is often a lag between accrual income and cash flow

Understanding Sources & Uses

Revenue

- A straight sale for cash is a source of cash
- **However** when the sale becomes a receivable, we have a use of cash. We, in essence, let our customer **use our cash**.
- The payment of a receivable by the customer is a **source of cash**.

Axiomate

Understanding Sources & Uses

Expense

- A straight purchase from a vendor * is a use of cash.
- **However** when that purchase is on account (they will bill and we will pay later) this becomes a **source of cash**.
- When we later pay the bill, it is a **use of cash**.

The Cash Flow Statement

- Largely a “different look” than other financial statements
  - Operations
  - Financing Activities
  - Investing Activities
- Only a few items of ‘new information’
  - Depreciation / Amortization
  - Acquisitions and deletions of fixed assets
  - Investment in company / Business Acquisitions
- Cash Flow explains changes in cash position as a calculation of other changes
  - It is mechanical

Netflix Balance Sheet

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

Assets

	2001	2002
Current assets:		
Cash and cash equivalents	$ 16,131	$ 59,814
Short-term investments	—	43,796
Prepaid expenses	1,019	2,753
Prepaid revenue sharing expenses	732	303
Other current assets	1,670	409
Total current assets	$ **19,552**	**107,075**

Change of Cash: $43,683

Deposits	1,677	1,690
Other assets	646	79
Total assets	$ **41,630**	$ **130,530**

	of December 31,	2002
	15	$ 20,350
	44	9,102
	37	9,743
	45	1,231
	57	—
	08	$ **40,426**
	40	288
	57	460
	99	—
	04	$ **41,174**
	30	
Convertible preferred stock, $0.001 par value; 8,500,000 and 10,000,000 shares authorized at December 31, 2001 and 2002, respectively; 6,157,499 and no shares issued and outstanding at December 31, 2001 and 2002, respectively; aggregate liquidation preference of $2,222 at December 31, 2001	6	—
Common stock, $0.001 par value; 100,000,000 and 150,000,000 shares authorized at December 31, 2001 and 2002, respectively; 2,161,855 and 22,445,795 issued and outstanding at December 31, 2001 and 2002, respectively	2	22
Additional paid-in capital	52,479	259,172
Deferred stock-based compensation	(5,725	(11,399
Accumulated other comprehensive income	—	774
Accumulated deficit	(137,266	(159,213
Total stockholders' (deficit) equity	$ **(90,504**	$ **89,356**
Total liabilities and stockholders' (deficit) equity	$ **41,630**	$ **130,530**

Netflix Cash Flow

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

	2000	2001	2002
Cash flows from operating activities:			
Net loss	$ (57,363)	$ (38,618)	$ (21,947)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	$ (22,706)	$ 4,847	$ 40,114
Cash flows from investing activities:			
Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988
Deposits and other assets	(1,189)	(586)	554
Net cash used in investing activities	$ (24,972)	$ (12,670)	$ (67,301)
Cash flows from financing activities:			
Proceeds from issuance of redeemable convertible preferred stock	50,011	—	—
Proceeds from issuance of common stock	422	125	88,020
Net proceeds from issuance of subordinated notes payable and detachable	—	12,831	—
Repurchases of common stock	(141)	(12)	(6)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
Net cash provided by financing activities	$ 48,375	$ 9,059	$ 70,870
Net increase in cash and cash equivalents	$ 697	$ 1,236	$ 43,683
Cash and cash equivalents, beginning of period	$ 14,198	$ 14,895	$ 16,131
Cash and cash equivalents, end of period	$ 14,895	$ 16,131	$ 59,814
	$ 697	$ 1,236	$ 43,683
Supplemental disclosure:			
Cash paid for interest	948	860	592
Noncash investing and financing activities:			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Operations

Investing

Financing

Change in Cash

Supplemental

Axiomate

Netflix Cash Flow

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

	2000	2001	2002
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Depreciation of property and equipment	3,605	5,507	5,919
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Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
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Cash flows from investing activities:			
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Purchases of property and equipment	(6,210)	(3,233)	(2,751)
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	$ 697	$ 1,236	$ 43,683

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Change in Cash

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Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Axiomate

Cash Flow from Operations

NETFLIX, INC.

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Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	$ (22,706)	$ 4,847	$ 40,114

Lost Money /

Positive Cash Flow

	2000	2001	2002
Net increase in cash and cash equivalents	$ 697	$ 1,236	$ 43,683
Cash and cash equivalents, beginning of period	$ 14,198	$ 14,895	$ 16,131
Cash and cash equivalents, end of period	$ 14,895	$ 16,131	$ 59,814
	$ 697	$ 1,236	$ 43,683

	2000	2001	2002
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Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Axiomate

Cash Flow
Cash from Operations

Cash from Operations

	What	Source of Numbers
Net Income	Bottom Line of Income Statement	Income Statement
Adjustments: Non Cash		
Amortization / Depreciation *	amount charged against income to match cost of asset to operations	Fixed asset register
Adjustments: changes in working capital	Change in balance of account one year to next	Calculation from Balance Sheet

Axiomate

Cash Flow
Cash from Operations

Cash from Operations

	Hardside	Softside
Net Income	Direct from income statement	
Adjustments: Non Cash		
Amortization / Depreciation *	Consistency	Depr / Amortization policies
Adjustments: changes in working capital	Current Period less Previous Period	

Cash Flow from Investing

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

		2000		2001		2002
Cash flows from operating activities:						
Net loss	$	**(57,363)**	$	**(38,618)**	$	**(21,947)**
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:						
Depreciation of property and equipment		3,605		5,507		5,919
Amortization of DVD library		15,681		22,127		17,417
Amortization of intangible assets		546		2,163		3,141
Noncash charges for equity instruments granted to non-employees		598		28		40
Stock-based compensation expense		8,803		5,686		9,831
Loss on disposal of property and equipment		145		—		—
Gain on disposal of DVDs		—		—		(1,674)
Noncash interest and other expense		497		1,017		11,384

Cash flows from investing activities:

Purchases of short-term investments		—		—		(43,022)
Proceeds from sale of short-term investments		6,322		—		—
Purchases of property and equipment		(6,210)		(3,233)		(2,751)
Acquisitions of DVD library		(23,895)		(8,851)		(24,070)
Proceeds from sale of DVDs		—		—		1,988
Deposits and other assets		(1,189)		(586)		554
Net cash used in investing activities	**$**	**(24,972)**	**$**	**(12,670)**	**$**	**(67,301)**

Misleading

Repurchases of common stock		(141)		(12)		[illegible]
Principal payments on notes payable and capital lease obligations		(1,917)		(3,885)		(17,144)
Net cash provided by financing activities	$	**48,375**	$	**9,059**	$	**70,870**
Net increase in cash and cash equivalents	$	**697**	$	**1,236**	$	**43,683**
Cash and cash equivalents, beginning of period	$	**14,198**	$	**14,895**	$	**16,131**
Cash and cash equivalents, end of period	$	**14,895**	$	**16,131**	$	**59,814**
	$	**697**	$	**1,236**	$	**43,683**
Supplemental disclosure:						
Cash paid for interest		948		860		592
Noncash investing and financing activities:						
Purchase of assets under capital lease obligations		3,000		520		583
Discount on capital lease obligation		105		172		—
Warrant issued as a deposit on operating lease		216		—		—
Exchange of Series F non-voting convertible preferred stock for intangible asset		6,128		4,498		1,318
Unrealized gain on short-term investments		—		—		774
Conversion of redeemable convertible preferred stock to common stock		—		—		101,830

Axiomate

Cash Flow
Cash used in Investing Activities

Cash from Investing Activities

	What	Source of Numbers
Purchases of property & equipment *	Total dollars paid for hard assets	Purchases journal
Purchase of subsidiary *	Total dollars paid for hard assets	Acquisition agreements / Cash disbursements journal
Acquisition costs incurred	Amounts paid for attorneys, consultants, etc to do a deal	Purchase or Cash disbursements journal

Axiomate

Cash Flow
Cash used in Investing Activities

Cash from Investing Activities

	Hardside	**Softside**
Purchases of property & equipment *	Cash paid	Capitalization Policy
Purchase of subsidiary *	Cash paid	Often debt or equity is used, valuation thereof can be very subjective if no market for debt / equity
Acquisition costs incurred	Cash paid	Capitalization Policy, otherwise this would be a period expense

Cash Flow from Financing

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

	2000	2001	2002
Cash flows from operating activities:			
Net loss	$ (57,363)	$ (38,618)	$ (21,947)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)

Cash flows from financing activities:			
Proceeds from issuance of redeemable convertible preferred stock	50,011	—	—
Proceeds from issuance of common stock	422	125	88,020
Net proceeds from issuance of subordinated notes payable and detachable	—	12,831	—
Repurchases of common stock	(141)	(12)	(6)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
Net cash provided by financing activities	**$ 48,375**	**$ 9,059**	**$ 70,870**

Sold some Stock

Proceeds from issuance of common stock	422	125	88,020
Net proceeds from issuance of subordinated notes payable and detachable	—	12,831	—
Repurchases of common stock	(141)	(12)	(6)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
Net cash provided by financing activities	$ 48,375	$ 9,059	$ 70,870

Net increase in cash and cash equivalents	$ 697	$ 1,236	$ 43,683
Cash and cash equivalents, beginning of period	$ 14,198	$ 14,895	$ 16,131
Cash and cash equivalents, end of period	$ 14,895	$ 16,131	$ 59,814
	$ 697	$ 1,236	$ 43,683

Supplemental disclosure:			
Cash paid for interest	948	860	592
Noncash investing and financing activities:			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Axiomate

Cash Flow
Cash used in Financing Activities

Cash from Financing Activities

	What	Source of Numbers
Proceeds from Investment	Net amounts of money raised	Cash receipts journal
Proceeds from Debt	Draws on debt	Cash receipts journal
Payments on debt	Reduction of debt	Cash disbursements journal

Axiomate

Cash Flow
Cash used in Financing Activities

Cash from Financing Activities

	Hardside	Softside
Proceeds from Investment	Cash paid	Gross vs net
Proceeds from Debt	Cash paid	Gross vs net
Payments on debt	Cash paid	Gross vs net

Cash Flow – Supplemental Disclosures

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

	2000	2001	2002
Cash flows from operating activities:			
Net loss	**$ (57,363)**	**$ (38,618)**	**$ (21,947)**
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	**$ (22,706)**	**$ 4,847**	**$ 40,114**
Cash flows from investing activities:			
Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988
Deposits and other assets	(1,189)	(586)	554

Supplemental disclosure:			
Cash paid for interest	948	860	592
Noncash investing and financing activities:			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Stock for Stock & Stock for Services

Cash paid for interest	948	860	592
Noncash investing and financing activities:			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Supplemental

Axiomate

Cash Flow
Supplemental Disclosures

Supplemental Disclosures

	What	Source of Numbers
Cash paid for interest	Interest component of debt service	Cash disbursements journal
Cash paid for income taxes	Actual cash portion of taxes	Cash disbursements journal
Issuance of stock / debt	Value assigned for stock debt issued in acquisition	Acquisition agreements
Other		

Cash Flow
Supplemental Disclosures

Supplemental Disclosures

	Hardside	Softside
Cash paid for interest	Cash paid	
Cash paid for income taxes	Cash paid	
Issuance of stock / debt	Market value of stock issued, if a public market exists	Often debt or equity is used, valuation thereof can be very subjective if no market for debt / equity
Other		

Netflix Cash Flow (cont)

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

	2000	2001	2002
Cash flows from operating activities:			
Net loss	$ (57,363)	$ (38,618)	$ (21,947)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
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Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
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Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	$ (22,706)	$ 4,847	$ 40,114
Cash flows from investing activities:			
Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988
Deposits and other assets	(1,189)	(586)	554
Net cash used in investing activities	$ (24,972)	$ (12,670)	$ (67,301)
Cash flows from financing activities:			
Proceeds from issuance of redeemable convertible preferred stock	50,011	—	—
Proceeds from issuance of common stock	422	125	88,020
Net proceeds from issuance of subordinated notes payable and detachable	—	12,831	—
Repurchases of common stock	(141)	(12)	(6)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
Net cash provided by financing activities	$ 48,375	$ 9,059	$ 70,870
Net increase in cash and cash equivalents	$ 697	$ 1,236	$ 43,683
Cash and cash equivalents, beginning of period	$ 14,198	$ 14,895	$ 16,131
Cash and cash equivalents, end of period	$ 14,895	$ 16,131	$ 59,814
	$ 697	$ 1,236	$ 43,683
Supplemental disclosure:			
Cash paid for interest	948	860	592
Noncash investing and financing activities:			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Operations

Investing

Financing

Change in Cash

Supplemental

Axiomate

What is E.B.I.T.D.A.

- Earnings Before
  - Interest
  - Taxes
  - Depreciation
  - Amortization
- It is a crude measure of cash flow
- ***What it is NOT: true cash flow***

Axiomate

Calculating EBITDA

Step 1 – Begin with Income Statement

	Year Ended December 31,					
		2000		2001		2002
Revenues:						
Subscription	$	35,894	$	74,255	$	150,818
Sales		—		1,657		1,988
Total revenues	**$**	**35,894**	**$**	**75,912**	**$**	**152,806**
Cost of revenues:						
Subscription		24,861		49,088		77,044
Sales		—		819		1,092
Total cost of revenues	**$**	**24,861**	**$**	[illegible]		[illegible]
Gross profit	**$**	**11,033**	**$**	[illegible]		[illegible]
Operating expenses:						
Fulfillment *		10,247		13,452		19,366
Technology and development *		16,823		17,734		14,625
Marketing *		25,727		21,031		35,783
General and administrative *		6,990		4,658		6,737
Restructuring charges		—		671		—
Stock-based compensation *		8,803		5,686		9,831
Total operating expenses	**$**	**68,590**	**$**	**63,232**	**$**	**86,342**
Operating loss	**$**	**(57,557)**	**$**	**(37,227))**	**$**	**(11,672)**
Other income (expense):						
Interest and other income		1,645		461		1,697
Interest and other expense		(1,451)		(1,852)		(11,992)
Net loss	$	**(57,363)**	$	**(38,618)**	$	**(21,967)**

EBITDA #1			**2000**	**2001**	**2002**
Item	Source				
Net Loss	**IS**	**$**	**(57,363)**	**$ (38,618)**	**$ (21,967)**

Axiomate

Calculating EBITDA

Step 2 – Deduct Interest, Taxes…

	Year Ended December 31, 2000	2001	2002
Revenues:			
Subscription	$ 35,894	$ 74,255	$ 150,818
Sales	—	1,657	1,988
Total revenues	**$ 35,894**	**$ [illegible]**	**$ [illegible]**
Cost of revenues:			
Subscription	24,861		
Sales	—		
Total cost of revenues	**$ 24.861**	**$**	
Gross profit	**$ 11,033**	**$ [illegible]**	**$ [illegible]**
Operating expenses:			
Fulfillment *	10,247	13,452	19,366
Technology and development *	16,823	17,734	14,625
Marketing *	25,727	21,031	35,783
General and administrative *	6,990	4,658	6,737
Restructuring charges	—	671	—
Stock-based compensation *	8,803	5,686	9,831
Total operating expenses	**$ 68,590**	**$ 63,232**	**$ 86,342**
Operating loss	**$ (57,557)**	**$ (37,227))**	**$ (11,672)**
Other income (expense):			
Interest and other income	1,645	461	1,697
Interest and other expense	(1,451)	(1,852)	(11,992)
Net loss	**$ (57,363)**	**$ (38,618)**	**$ (21,967)**

EBITDA #1			2000	2001	2002
Item	Source				
Net Loss	**IS**	**$**	**(57,363)**	**$ (38,618)**	**$ (21,967)**
Interest	**IS**		(194)	1,391	10,295
Taxes	**IS**		0	0	0

Axiomate

Calculating EBITDA

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

	2000	2001	2002
Cash flows from operating activities:			
Net loss	$ (57,363)	$ (38,618)	$ (21,947)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue			4,806
Deferred rent			48
Net cash (used in) provided by operati			$ 40,114

Cash and cash equivalents, end of period

EBITDA #1 Item	Source	2000	2001	2002
Net Loss	IS	$ (57,363)	$ (38,618)	$ (21,967)
Interest	IS	(194)	1,391	10,295
Taxes	IS	0	0	0
Depr / Amort	CF	$ 19,832	$ 29,797	$ 26,477
EBITDA		$ (37,725)	$ (7,430)	$ 14,805

	2000	2001	2002
Supplemental disclosure:			
Cash paid for interest			
Noncash investing and financing activities:			
Purchase of assets under capital lease obligatio			
Discount on capital lease obligation			
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Axiom ...e, Inc.

How Good is EBITDA as a Measure of Cash Flow?

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

EBITDA #1			2000		2001		2002
Item	Source						
Net Loss	IS	$	(57,363)	$	(38,618)	$	(21,967)
Interest	IS		(194)		1,391		10,295
Taxes	IS		0		0		0
Depr / Amort	CF	$	19,832	$	29,797	$	26,477
EBITDA		$	(37,725)	$	(7,430)	$	14,805

Cash flows from operating activities:

	2000	2001	2002
Net loss			
Adjustments to reconcile			
Depreciation of property a			
Amortization of DVD librar			
Amortization of intangible			
Noncash charges for equit			
Stock-based compensation			
Loss on disposal of proper			
Gain on disposal of DVDs			
Noncash interest and othe			
Changes in operating asse			
Prepaid expenses and othe			
Accounts payable			
Accrued expenses			
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	$ (22,706)	$ 4,847	$ 40,114

		2000		2001		2002
Actual Change in Cash	$	697	$	1,236	$	43,683
Cash from Operations	$	(22,706)	$	4,847	$	40,114

Supplemental disclosure	2000	2001	2002
Cash paid for interest			
Noncash investing and fi			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

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How Good is EBITDA as a Measure of Cash Flow?

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

	2000	2001	2002
Cash flows from operating activities:			
Net loss	$ (57,363)	$ (38,618)	$ (21,947)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
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Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	$ (22,706)	$ 4,847	$ 40,114

What about the other "non-cash" items?

Actual Change in Cash	$ 697	$ 1,236	$ 43,683
Cash from Operations	$ (22,706)	$ 4,847	$ 40,114

	2002
	$ (21,967)
	10,295
	0
	$ 26,477
	$ 14,805

Supplemental disclosure
Cash paid for interest
Noncash investing and fi

Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Cash and cash equivalent

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Revised Look at EBITDA

EBITDA #2		2000	2001	2002
Item	Source			
Net Loss	**IS**	**$ (57,363)**	**$ (38,618)**	**$ (21,967)**
Interest	**IS**	(194)	1,391	10,295
Taxes	**IS**	-	-	-
Depr / Amort	**CF**	$ 19,832	$ 29,797	$ 26,477
EBITDA #1		**$ (37,725)**	**$ (7,430)**	**$ 14,805**
Noncash charges for equity instruments granted to non-employees		$ 598	$ 28	$ 40
Stock-based compensation expense		$ 8,803	$ 5,686	$ 9,831
Loss on disposal of property and equipment		$ 145	—	—
Gain on disposal of DVDs		—	—	$ (1,674)
Noncash interest and other expense		$ 497	$ 1,017	$ 11,384
EBITDA #2		**$ (27,682)**	**$ (699)**	**$ 34,386**
Cash from Operations		**$ (22,706)**	**$ 4,847**	**$ 40,114**

Axiomate

Revised Look at EBITDA

	2000	2001	2002
Cash flows from operating activities:			
Net loss	$ (57,363)	$ (38,618)	$ (21,947)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
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Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	$ (22,706)	$ 4,847	$ 40,114

Change in WC
$4782

	2000	2001	2002
EBITDA #2	$ (27,682)	$ (699)	$ 34,386
Cash from Operations	$ (22,706)	$ 4,847	$ 40,114

Axiomate, Inc.

Axiomate

EBITDA vs.. Cash Flow

- 2002 EBITDA – $14.5M vs.. change of cash of $.7M and cash flow from ops of $40M
- EBITDA is crude
  - Depreciation is, long term, a real number
    - Assets have to be replaced
  - Taxes and interest are real uses of cash
  - Real cash is affected by changes in balance sheet
    - Particularly working capital
- Cash Flow is crude
  - It is a mechanical explanation of the change in cash position

Axiomate

Calculating Cash Flow Dynamics

Days Sales in Receivables

AR Balance *	$ 27,000			
		0.177	360	**63.6**
Sales	$ 152,806			

Days Costs in Payables

AP Balance *	$ 13,715			
		0.208	360	**75.0**
Cost of goods	$ 78,136			
Opex	$ 86,342			
Less: payroll/rent	$ (98,687)			
	$ 65,791			

Axiomate

Understanding your Unique Cash Flow

- YOU MUST UNDERSTAND
  - Days Sales
    - How long does it take a receivable to turn to cash
  - Payables
    - What is average days payable
    - What must you pay currently, 30 days, what gets stretched
  - To what extent does your business have "deferrals"

Managing Float –
(the Holes of Cash Inflow)

- Invoicing Float
  - Time goods / services are delivered to time invoiced
    - Particular issue with professional services firm
- Mail Float
  - Time it takes for invoice to get to customer
  - Time it takes for “check to be in the mail.”
- Customer Processing Float
  - Time it takes for customer to receive, code, approve and pay invoice
- Company Processing Float
  - Time it takes to get the check from the mail, posted and to the bank
- Bank Processing Float
  - Time it takes from deposit to available funds
  - Time it takes from available funds to a cleared check

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The role of the CFO in cash control

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Axiomate, Inc.

Dissecting The Footnotes to Financial Statements

Axiomate

Read the Footnotes

NETFLIX, INC.
NOTES TO FINANCIAL STATEMENTS
Years Ended December 31, 2000, 2001 and 2002

(in thousands, except share, per share and per DVD data)

1. Organization and Significant Accounting Policies

Description of business

Netflix, Inc. (the "Company"), was incorporated on August 29, 1997 (inception) and began operations on April 14, 1998. The Company is an online subscriptions-based digital video disk ("DVD") rental service, providing subscribers with access to a comprehensive library of titles. For $19.95 a month, subscribers can rent as many DVDs as they want, with three movies out at a time, and keep them for as long as they like. There are no due dates and no late fees. DVDs are delivered directly to the subscriber's address by first-class mail from distribution centers throughout the United States. The Company can reach more than half of its subscribers with generally next-day service. The Company also provides background information on DVD releases, including reviews, member reviews and ratings and personalized movie recommendations. For more information on the company, visit www.netflix.com.

Initial public offering

On May 29, 2002, the Company closed the sale of 5,500,000 shares of common stock and on June 14, 2002, the Company closed the sale of an additional 825,000 shares of common stock, in an initial public offering at a price of $15.00 per share. A total of $94,875 in gross proceeds was raised from these transactions. After deducting the underwriting fee of approximately $6,641 and approximately $2,060 of other offering expenses, net proceeds were approximately $86,174. Upon the closing of the initial public offering, all preferred stock was automatically converted into common stock.

Cash and cash equivalents

The Company considers highly liquid instruments with original maturities of three months or less, at the date of purchase, to be cash equivalents. The Company's cash and cash equivalents are principally on deposit in short-term asset management accounts at two large financial institutions.

Short-term investments

Short-term investments generally mature between three months and five years from the purchase date. The Company has the ability to convert these short-term investments into cash at anytime without penalty. All short-term investments are classified as available-for-sale and are recorded at market value using the specific identification method. Unrealized gains and losses are reflected in other comprehensive loss and accumulated other comprehensive income. As of December 31, 2002, all short-term investments were invested in the Vanguard Short-Term Bond Index Fund—Admiral Shares (the "Fund"). The target index, for the Fund, the Lehman 1-5 Year Government/Credit Bond Index (the "Index"), is comprised of approximately 1,500 U.S. Treasury and agency securities and investment-grade corporate bonds with maturities between 1 and 5 years. As of December 31, 2002, the cost, unrealized gain and market value was $43,022, $774 and $43,796, respectively.

DVD library

Historically, the Company purchased DVDs from studios and distributors. In 2000 and 2001, the Company entered into a series of revenue sharing agreements with several studios which changed the business model for acquiring DVDs and satisfying subscriber demand. These revenue sharing agreements enable the Company to obtain DVDs at a lower up front cost than under traditional buying arrangements. The Company shares a percentage of the actual net revenues generated by the use of each particular title with

"The financial statements are a snapshot. The footnotes ARE the story."

Axiomate, Inc.

Axiomate

Dissecting the Footnotes

- The real substance of the financial statements
  - Accounting policies
  - Debt terms and debt service
  - Commitments and contingencies (litigation)
  - Off balance sheet financing (leases)
  - Unusual transactions and relationships
    - Related parties
    - Segment reporting
  - Equity division and shareholder rights
  - Employee benefit plans
  - Subsequent events
- Read Carefully!

Dissecting the Footnotes
Accounting Policies

Accounting Policies

	What	Reading between the Lines
The Company	Company background including date of incorporation, what it does	Wonder about non-typical entries
Concentration of Risk	Tells you about customer concentrations, regional concentrations, foreign currency issues, credit risks	Please do!
Revenue Recognition	Tells you when sales are recorded in cases where that is not clear (software licensing, maintenance agreements, consulting services)	Important to understand when company has "deferred revenue accounts" or product may be long-term or returnable
Balance Sheet Recognition	Property & Equipment amortization, capitalization of R&D, income taxes	Look for consistently aggressive or consistently soft methods and changes in methods
Stock Based Compensation	How the Company records value of stock and options issued to employees	You will be scratching your head
New Accounting Pronouncements	Tells about company stand on new GAAP rules	Companies elect early adoption when it produces better results. Consider the change

Axiomate

Footnote 1 – Accounting Policies

1. Organization and Significant Accounting Policies

Description of business

Netflix, Inc. (the "Company"), was incorporated on August 29, 1997 (inception) and began operations on April 14, 1998. The Company is an online subscriptions-based digital video disk ("DVD") rental service, providing subscribers with access to a comprehensive library of titles. For $19.95 a month, subscribers can rent as many DVDs as they want, with three movies out at a time, and keep them for as long as they like. There are no due dates and no late fees. DVDs are delivered directly to the subscriber's address by first-class mail from distribution centers throughout the United States. The Company can reach more than half of its subscribers with generally next-day service. The Company also provides background information on DVD releases, including reviews, member reviews and ratings and personalized movie recommendations. For more information on the company, visit www.netflix.com.

transactions. After deducting the underwriting fee of approximately $6,641 and approximately $2,060 of

Revenue recognition

Subscription revenues are recognized ratably during each subscriber's monthly subscription period. Refunds to customers are recorded as a reduction of revenues or deferred revenue, as appropriate. Revenues from sales of DVDs are recorded upon shipment. Prior to adopting a subscription model in September 1999, revenues from individual DVD rentals were recorded upon shipment.

Cost of revenues

Cost of subscription revenues consists of revenue sharing costs, amortization of the DVD library, amortization of intangible assets related to equity instruments issued to studios and postage and packaging costs related to DVDs provided to paying subscribers. Cost of revenues for DVD sales includes the salvage value of used DVDs that have been sold. Revenue sharing expense is recorded as DVDs subject to revenue sharing agreements are shipped to subscribers.

$43,022, $774 and $43,796, respectively.

Capitalized software costs

The Company capitalizes costs related to developing or obtaining internal-use software. Capitalization of costs begins after the conceptual formulation stage has been completed. Capitalized software costs are included in internal-use software in property and equipment and amortized over the estimated useful life of the software, which ranges from one to two years.

Footnote 1 – Accounting Policies (cont)
Use of Estimates

Fair value of financial instruments

The fair value of the Company's cash, accounts payable and borrowings approximates their carrying values due to their short maturity or fixed-rate structure.

Use of estimates

The preparation of 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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Footnote 1 – Accounting Policies (cont)

DVD library

Historically, the Company purchased DVDs from studios and distributors. In 2000 and 2001, the Company entered into a series of revenue sharing agreements with several studios which changed the business model for acquiring DVDs and satisfying subscriber demand. These revenue sharing agreements enable the Company to obtain DVDs at a lower up front cost than under traditional buying arrangements. The Company shares a percentage of the actual net revenues generated by the use of each particular title with the studios over a fixed

Accounting Change

period of time, which is typically 12 months for each DVD title (hereinafter referred to as the "title term"). At the end of the title term, the Company has the option of either returning the DVD title to the studio or purchasing the title. Before the change in business model, the Company typically acquired fewer copies of a particular title upfront and utilized each copy acquired over a longer period of time. The implementation of these revenue sharing agreements improved the Company's ability to obtain larger quantities of newly released titles and satisfy subscriber demand for such titles over a shorter period of time.

In connection with the change in business model, on January 1, 2001, the Company revised the amortization policy for the cost of its DVD library from an accelerated method using a three year life to the same accelerated method of amortization over one year. The change in life has been accounted for as a change in accounting estimate and is accounted for on a prospective basis from January 1, 2001. Had the DVDs acquired prior to January 1, 2001 been amortized using the three year life, amortization expense for 2001 would have been $4,700 lower than the amount recorded in the accompanying financial statements, which represents a $2.57 per share impact on loss per share in 2001.

Under certain revenue sharing agreements, the Company remits an upfront payment to acquire titles from the studios. This payment includes a contractually specified initial fixed license fee that is capitalized and amortized in accordance with the Company's DVD library amortization policy. Some payments also include a contractually specified prepayment of future revenue sharing obligations that is classified as prepaid revenue sharing expense and is charged to expense as future revenue sharing obligations are incurred.

Several studios permit the Company to sell used DVDs upon the expiration of the title term. For those DVDs that the Company estimates it will sell at the end of the title term, a salvage value of $2.00 per DVD is provided. For those DVDs that the Company does not expect to sell, no salvage value is provided. As of December 31, 2001 and 2002, the salvage values of $578 and $929, respectively, are included in DVD library in the accompanying financial statements.

During 2000, the Company's DVDs were amortized on an accelerated method (sum of the years digits method) over a period of three years with no salvage value.

DVD library and accumulated amortization consisted of the following

Footnote 1 – Accounting Policies (cont)

Net loss per share

Basic net loss per share is computed using the weighted-average number of outstanding shares of common stock, excluding common stock subject to repurchase. Diluted net loss per share is computed using the weighted-average number of outstanding shares of common stock and, when dilutive, potential common stock from outstanding options and warrants to purchase common stock, using the treasury stock method, and convertible securities using the "if-converted" method. All potential common stock issuances have been excluded from the computations of diluted net loss per share for all periods presented because the effect would be antidilutive.

Diluted net loss per share does not include the effect of the following antidilutive common equivalent shares (rounded to nearest thousand):

	At December 31,			2002	
	2000	**2001**	**2002**	**Weighted Average Exercise Price**	
ck options outstanding	1,139,000	2,999,000	4,101,000	$	3.42
rrants outstanding	236,000	7,018,000	6,278,000	$	3.23
mmon stock subject to urchase	509,000	140,000	8,000	$	2.98
	1,884,000	10,157,000	10,387,000	$	3.31
deemable convertible preferred ck	6,772,000	9,660,000	—	$	—
nvertible preferred stock	1,859,000	3,123,000	—	$	—
	10,515,000	22,940,000	10,387,000	$	3.31

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Footnote 1 – Accounting Policies (cont) Impact of Accounting Rule Changes

Recently issued accounting standards

In June 2001, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 143, *Accounting for Asset Retirement Obligations* . SFAS No. 143 requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from acquisition, construction, development, and/or normal use of the assets. The Company also will record a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company is required to adopt SFAS No. 143 on January 1, 2003. The adoption of SFAS No. 143 is not expected to have a material effect on the Company’s financial statements.

Footnote 1 – Accounting Policies (cont)
Stock Based Compensation

Stock-based compensation

The Company accounts for its stock-based employee compensation plans using the intrinsic-value method. Deferred stock-based compensation expense is recorded if, on the date of grant, the current market value of the underlying stock exceeds the exercise price. Deferred compensation resulting from repriced options is calculated pursuant to FASB Interpretation No. 44, *Accounting for Certain Transactions involving Stock Compensation* . Options granted to nonemployees are considered compensatory and are accounted for at fair value pursuant to Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* . The Company discloses the pro forma effect of using the fair value method of accounting for all employee stock-based compensation arrangements in accordance with SFAS No. 123.

In 2001, the Company offered employees and directors the right to exchange certain stock options. The Company exchanged options to purchase approximately 900,000 shares of common stock with varying exercise prices in exchange for options to purchase approximately 900,000 shares of common stock with an exercise price of $3.00 per share. As of December 31, 2002, exchanged options for approximately 635,000 shares of common stock were outstanding. The stock option exchange resulted in variable award accounting treatment for all of the exchanged options. Variable award accounting will continue until all options subject to variable accounting are exercised, cancelled or expire. Variable accounting treatment will result in unpredictable and potentially significant charges or credits to the Company's operating expenses from fluctuations in the market price of the Company's common stock. For each hypothetical one-dollar increase or decrease in the fair value of the Company's common stock, the Company will record deferred compensation in an amount equal to the number of shares underlying the variable awards multiplied by the one-dollar change. However, to the extent these variable awards are not fully vested, the stock-based compensation expense will be less than the amount recorded as deferred compensation.

$10.38, respectively.

Footnote 1 – Accounting Policies (cont)
Stock Based Compensation

SFAS No. 123 requires the disclosure of net loss as if the Company had adopted the fair value method for its stock-based compensation arrangements for employees since the inception of the Company. SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure, an Amendment of FASB Statement No. 123*, amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosures modifications are required for fiscal years ending after December 15, 2002 and are presented below. Had compensation cost been determined consistent with SFAS No. 123, the Company's net loss and net loss per share would have been as follows:

	Year Ended December 31, 2000	2001	2002
t loss as reported	$ (57,363)	$ (38,618)	$ (21,947)
d stock-based employee compensation expense included in orted net loss	8,803	5,686	9,831
duct total stock-based employee compensation expense ermined under the fair value method	(9,714)	(6,250)	(8,832)
forma net loss	$ (58,274)	$ (39,182)	$ (20,948)
sic and diluted net loss per share:			
reported	$ (40.57)	$ (21.15)	$ (1.56)
forma	$ (41.21)	$ (21.46)	$ (1.49)

The fair value of each option was estimated on the date of grant using the minimum-value method, prior to the Company's initial public offering, with the following weighted-average assumptions: no dividend yield; volatility of 0%, 0%, 69%; risk-free interest rate of 6.24%, 4.14% and 2.79% for 2000, 2001 and 2002, respectively; and expected life of 3.5 years for all periods.

The weighted-average fair value of options granted in fiscal 2000, 2001, and 2002 was $24.12, $0.32 and $10.38, respectively.

Footnote 1 – Accounting Policies (cont)
Miscellaneous

Income taxes

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

Comprehensive loss

Comprehensive loss consists of net loss and other gains and losses affecting stockholders' equity that, under generally accepted accounting principles, are excluded from net loss, such as unrealized gains and losses on investments available for sale. The balances in accumulated other comprehensive income consist of unrealized gains on short-term investments.

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Dissecting the Footnotes – Other footnotes

Other

	What	Reading between the Lines
Qualification Footnote	If auditors qualify an opinion, the explanation will be here	Ponder
Acquisitions	Price paid to acquire a subsidiary. Generally will help reconcile cash paid to goodwill	Issue of stock and debt is often soft money. Challenge when large amounts of Goodwill are created
Debt	Key terms associated with company borrowing	Look for unreasonable interest, balloon payments, unique covenants, extent of collateral, other unique terms. Read very carefully. Secured creditors often call the shots in troubled companies.
Commitments and Contingencies	Off-Balance Sheet obligations: Leases and lawsuits	This IS the "between the lines" of the financial statements. Obligations addressed here do not work into balance sheet ratios, hence very important information about company viability can be "innocently" buried here
Income Taxes	Calculation of companies tax liability for book purposes reconciled to expected tax returns	All companies keep two sets of books: financial statements and tax returns. This is the reconciling account. This footnote shows the accounts where taxes differ from books
Preferred Stock / Convertible Debt	Key terms associated with preferred debt and preferred share issues	The holders of these issues are often "fence straddlers." People that look at company from debt perspective often consider these shareholders, people that take a shareholder perspective look at these creditors. Both assessments are incomplete. Look hard a terms of their deal. They often have most of the power in the Company.
Common Stock	Shows the true equity picture with consideration for conversion of preferred and consideration for option and warrant holders	Options and warrants are off-balance sheet equity holders. Also provides indication of corporate culture and alignment of employees (how pervasive is stock issued? Are employees "in the money?")
Subsequent Events	Important Developments after balance sheet date	Read and consider. This single disclosure could have a MAJOR impact on the whole set of financial statements, almost rendering them moot, in some cases
Segment Information	Companies organization from a financial perspective	Where does the money really come from? What changes are going on here?

Footnote 2 – Property & Equipment

Sometimes called PP&E

2. Property and Equipment, Net

Property and equipment consisted of the following:

	As of December 31, 2001	As of December 31, 2002
Computer equipment	$ 9,245	$ 10,612
Internal-use software	5,285	6,660
Furniture and fixtures	2,033	2,616
Leasehold improvements	1,627	1,636
	18,190	21,524
Less accumulated depreciation	(9,985)	(15,904)
	$ 8,205	$ 5,620

Property and equipment includes approximately $5,554 and $6,173 of assets under capital leases as of December 31, 2001 and 2002, respectively. Accumulated amortization of assets under these leases totaled $3,701 and $5,176 as of December 31, 2001 and 2002, respectively. Internal-use software includes approximately $2,795 and $3,948 of internally incurred capitalized software development costs as of December 31, 2001 and 2002, respectively. Accumulated amortization of capitalized software development costs totaled $1,835 and $3,024 as of December 31, 2001 and 2002, respectively.

Footnote 3 Aspen – Acquisitions

How?

(a) Acquisitions During Fiscal Year 2002

On May 31, 2002, the Company acquired Hyprotech Ltd. and related subsidiaries of AEA Technology plc (collectively, Hyprotech), a market leader in providing software and service solutions designed to improve profitability and operating performance for process industry clients by simulating plant design and operations. The Company acquired 100% of the outstanding capital of Hyprotech for a purchase price of approximately $106.1 million, consisting of $96.6 million in cash, $1.1 million in accrued exit costs, and $8.4 million in transaction costs. This acquisition was accounted for as a purchase, and accordingly, the results of operations from the date of acquisition are included in the Company's consolidated statements of operations commencing as of the acquisition date.

The purchase price was allocated to the fair market value of assets acquired and liabilities assumed, as follows (in thousands):

Description		Amount	Life
Purchased in-process research and development	$	14,900	—
Goodwill		57,512	—
Acquired technology		23,800	5 years
Customer contracts		1,000	4 years
		97,212	
Net book value of tangible assets acquired, less liabilities assumed		16,284	
		113,496	
Less — Deferred taxes		7,440	
Total purchase price	$	106,056	

Footnote 3 Aspen – Acquisitions

What IF?

The following table represents selected unaudited pro forma combined financial information for the Company and Hyprotech, assuming the companies had combined at the beginning of fiscal 2001 (in thousands, except per share data):

	Years Ended June 30,	
	2001	**2002(1)**
forma revenue	$ 375,701	$ 366,426
forma net income (loss)	(21,327)	(69,811)
forma net income (loss) applicable to common shareholders	(21,327)	(76,112)
forma earnings (loss) per share applicable to common shareholders	$ (0.63)	$ (2.12)
forma weighted average common shares outstanding	34,108	35,912

(1) Does not reflect the charge for in-process research and development

Pro forma results are not necessarily indicative of either actual results of operations that would have occurred had the acquisition been made at the beginning of fiscal 2001 or of future results.

Footnote 4 – Debt and Warrants

Capital lease obligations

The Company has entered into capital leases for the acquisition of equipment. The Company has outstanding capitalized lease obligations under these arrangements of $2,402 and $1,691 as of December 31, 2001 and December 31, 2002, respectively. Such amounts are payable in monthly installments of principal and interest with effective interest rates ranging between 14.4% and 17.0% per annum.

Notes payable

The Company had a note payable to Lighthouse Capital Partners II, L.P. with an unpaid balance of $1,667 as of December 31, 2001. The note payable was secured by substantially all of the assets of the Company, accrued interest at 12% per annum and was fully paid-off in August 2002.

Subordinated notes payable

In July 2001, the Company issued subordinated promissory notes and warrants to purchase 6,818,947 shares of its common stock at an exercise price of $3.00 per share for net proceeds of $12,831. The subordinated notes had an aggregate face value of $13,000 and stated interest rate of 10%. Approximately $10,884 of the proceeds was allocated to the warrants as additional paid-in capital and $1,947 was allocated to the subordinated notes payable. The resulting discount of $11,053 was being accreted to interest expense using an effective annual interest rate of 21%. The face value of the subordinated notes and all accrued interest were due and payable upon the earlier of July 2011 or the consummation of a qualified initial public offering. As of December 31, 2001, accrued and unpaid interest of $650 was included in the carrying amount of the subordinated notes payable balance of $2,799 in the accompanying financial statements. The Company consummated a qualified initial public offering on May 29, 2002 and repaid the face value and all accrued interest on the subordinated promissory notes. In April 2002, the FASB issued FAS No. 145, *Recision of FASB Statements no. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections Under Statement 4* , pursuant to which all gains and losses from extinguishments of debt were required to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. This statement eliminates Statement 4 and, thus, the exception to applying Opinion 30 to all gains and losses related to extinguishments of debt. The Company adopted FAS 145 during 2002, and as a result, has classified the charge related to the unamortized discount upon repayment of the subordinated notes payable as other expense, instead of extraordinary loss on extinguishment of debt, in the accompanying statements of operations.

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Footnote 4 – Debt and Warrants (cont)

Warrants and common stock issued with debt instruments

In May 2000, in connection with a capital lease, the Company issued a warrant that provided the lender the right to purchase 7,669 shares of common stock at $19.56 per share. The Company accounted for the fair value of the warrant of approximately $105 as an increase to additional paid-in capital with a corresponding provision to debt discount. The debt discount is being accreted to interest expense over the term of the related debt, which is 36 months.

In July 2001, in connection with borrowings under subordinated promissory notes, the Company issued to the note holders warrants to purchase 6,818,947 shares of common stock. The Company accounted for the fair value of the warrants of $10,884 as an increase to additional paid-in capital with a corresponding discount on subordinated notes payable.

In July 2001, in connection with a capital lease agreement, the Company granted warrants to purchase 85,000 shares of common stock at an exercise price of $3.00 per share. The fair value of approximately $172 was recorded as an increase to additional paid-in capital with a corresponding reduction to the capitalized lease obligation. The debt discount is being accreted to interest expense over the term of the lease agreement which is 45 months.

The fair values of warrants were estimated at the date of issuance of each warrant using the Black-Scholes valuation model with the following assumptions: the term of the warrant; risk-free rates between 4.92% to 6.37%; volatility of 80% for all periods; and a dividend yield of 0.0%.

Warrants, options and common stock issued in exchange for cash and services rendered

In March 2000, in consideration for employee recruiting and placement services rendered, the Company issued 7,258 shares of common stock to a consultant. The Company recorded the fair value of the common stock issued of $306 as marketing expense.

Also in March 2000, in consideration for marketing services rendered, the Company issued an option to a consultant to purchase 5,000 shares of common stock at $13.50 per share. The Company recorded the fair value of the option of approximately $195 as marketing expense.

In April 2000, in connection with the sale of Series E preferred stock, the Company sold warrants to purchase 533,003 shares of Series E preferred stock at a price of $0.01 per share. The warrants have an exercise price of $14.07 per share. The proceeds from the sale of these warrants were recorded as part of the issuance of Series E preferred stock in the accompanying statement of stockholders' (deficit) equity. In July 2001, in connection with a modification of the terms of the Series E preferred stock, certain Series E warrant holders agreed to the cancellation of warrants to purchase 500,487 shares of Series E preferred stock. The remaining warrants to purchase 32,516 shares are exercisable at $14.07 per share.

In November 2000, in connection with an operating lease, the Company issued a warrant that provided the lessor the right to purchase 20,000 shares of common stock at $6.00 per share. The Company also issued an option, in connection with the lease to a consultant to purchase 8,333 shares of common stock at $6.00 per share. The Company accounted for the fair value of the warrant of approximately $216 as an increase to additional paid-in capital with a corresponding increase to other assets. This asset is being amortized over the term of the related operating lease, which is five years. The Company recorded the fair value of the option of approximately $90 as general and administrative expense.

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Footnote 5 – Commitments & Contingencies

Lease commitments

The Company leases its primary facilities under noncancelable operating leases. The Company also has capital leases with various expiration dates through March 2005. Future minimum lease payments under noncancelable capital and operating leases as of December 31, 2002, are as follows:

Year Ending December 31,	Capital Leases	Operating Leases
2003	$ 1,326	$ 2,952
2004	462	2,640
2005	56	1,466
Total minimum payments	1,844	$ 7,058
Less interest and unamortized discount	(153)	
Present value of net minimum lease payments	1,691	
Less current portion of capital lease obligations	(1,231)	
Capital lease obligations, noncurrent	$ 460	

Rent expense for the years ended December 31, 2000, 2001 and 2002 was $1,533, $2,450 and $2,975, respectively. Rent expense is computed using the straight-line method and the minimum operating lease payments required over the lease term.

The Company is subject to legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's financial statements.

Footnote 5 Aspen – Commitments & Contingencies

(a) FTC investigation

By letter of June 7, 2002, the FTC informed the Company that it was conducting an investigation into the competitive effects of its recent acquisition of Hyprotech. Because this investigation is in its early stages, the Company cannot be certain whether the FTC might seek any relief or the nature of any such relief that might be sought. The FTC may determine to challenge the acquisition through an administrative civil complaint seeking to declare the acquisition in violation of Section 7 of the Clayton Act or Section 5 of the FTC Act. If the FTC were to prevail in that challenge, it could seek to impose a wide variety of remedies, some of which may have a material adverse effect on the Company's ability to continue to operate under its current business plans. These potential remedies include divestiture of Hyprotech, as well as mandatory licensing of Hyprotech software products and the Company's other engineering software products to one or more of its competitors.

Footnote 6 – Convertible Debt

6. Redeemable Convertible Preferred Stock

The redeemable convertible preferred stock at December 31, 2001 consisted of the following:

	Par Value	Number of Shares Authorized	Number of Shares Issued and Outstanding	Dividends Per Share	Redemption and Liquidation Value Per Share	Total Liquidation Value
Series B	$ 0.001	5,776,616	5,684,024	$ 0.08648	$ 1.08	$ 6,139
Series C	0.001	4,750,000	4,650,269	0.2616	3.27	15,205
Series D	0.001	4,650,000	4,649,927	0.5216	6.52	30,318
Series E	0.001	5,874,199	5,007,530	0.7500	9.38	46,971
Series E-1	0.001	5,874,199	325,159	0.7500	9.38	3,050
		26,925,014	20,316,909			$ 101,683

Conversion

These shares automatically converted into 9,659,700 shares of common stock upon the closing of the Company's initial public offering.

Footnote 7 – Shareholder Equity

- Description of Shares
  - Number of shares authorized and issued
  - Voting rights
  - Conversion rights
  - Redemption and liquidation rights
- Stock options
  - Size and basic terms of plan.
  - Shares granted, exercised and forfeited by year
  - Minimum and maximum exercise prices. Weighted average of exercise prices
  - Value of options (Black-Scholes)
- Often a separate footnote for 1) common stock; 2) preferred stock and 3) options

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Footnote 7 – Shareholder Equity (cont)

The convertible preferred stock at December 31, 2001 consisted of the following:

	Par Value	Number of Shares Authorized	Number of Shares Issued and Outstanding	Dividends Per Share	Liquidation Value Per Share	Total Liquidation Value
Series A	$ 0.001	5,000,000	4,444,545	$ 0.0500	$ 0.50	$ 2,222
Series F	0.001	3,500,000	1,712,954	—	—	—
		8,500,000	6,157,499			$ 2,222

The Company's obligation to maintain the studios equity interests at 6.02% of the Company's fully diluted equity securities, as discussed in note 1, resulted in the Company issuing 3,492,737 shares of Series F Non-Voting Convertible Preferred Stock to the studios during 2002. This obligation terminated immediately prior to the Company's initial public offering. All the outstanding convertible preferred stock automatically converted into 3,216,740 shares of common stock upon the closing of the Company's initial public offering.

Footnote 7 – Shareholder Equity (cont) - Options

Stock option plans

As of December 31, 2001, the Company was authorized to issue up to 4,879,978 shares of common stock in connection with its 1997 stock option plan for directors, employees and consultants. The 1997 stock option plan provides for the issuance of stock purchase rights, incentive stock options or non-statutory stock options. 321,942 remaining shares reserved but not yet issued under the 1997 plan as of the effective date of the Company's initial public offering were added to the total reserved shares under the 2002 Stock Plan and deducted from the total reserved shares under the 1997 Stock Plan.

In February 2002, the Company adopted the 2002 Stock Plan. The 2002 Stock Plan provides for the grant of incentive stock options to employees and for the grant of nonstatutory stock options and stock purchase rights to employees, directors and consultants. The Company reserved a total of 666,667 shares of common stock for issuance under the 2002 Stock Plan. 321,942 remaining shares reserved but not yet issued under the 1997 plan as of the effective date of the Company's initial public offering were added to the total reserved shares of 666,667 under the 2002 Stock Plan and deducted from the total reserved shares under the 1997 Stock Plan. In addition, the Company's 2002 Stock Plan provides for annual increases in the number of shares available for issuance under the Company's 2002 Stock Plan on the first day of each fiscal year, beginning with the Company's fiscal year 2003, equal to the lesser of 5% of the outstanding shares of common stock on the first day of the applicable fiscal year, 1,000,000 shares, and another amount as the Company's board of directors may determine.

Stock purchase rights are subject to a restricted stock purchase agreement whereby the Company has the right to repurchase the stock at the original issue price upon the voluntary or involuntary termination of the purchaser's employment with the Company. The repurchase rights lapse at a rate determined by the stock plan administrator but at a minimum rate of 25% per year.

The exercise price for incentive stock options is at least 100% of the stock's fair value on the date of grant for employees owning less than 10% of the voting power of all classes of stock, and at least 110% of the fair value on the date of grant for employees owning more than 10% of the voting power of all classes of stock. For nonstatutory stock options, the exercise price is also at least 110% of the fair value on the date of grant for service providers owning more than 10% of the voting power of all classes of stock and no less than 85% of the fair value on the date of grant for service providers owning less than 10% of the voting power of all classes of stock.

Axiomate

Footnote 7 – Shareholder Equity (cont) - Options

A summary of the activities related to the Company's options for the years ended December 31, 2000 and 2002 and is as follows:

	Shares Available for Grant	Options Outstanding: Number of Shares		Options Outstanding: Weighted-Average Exercise Price
Balances as of January 1, 2000	611,313	531,031	$	4.
Authorized	587,284	—		—
Granted	(849,466)	849,466		9.
Exercised	—	(81,003)		5.
Canceled	160,475	(160,475)		7.
Repurchased	26,653	—		5.
Balances as of December 31, 2000	536,259	1,139,019		7.
Authorized	3,133,333	—		—
Granted	(3,457,659)	3,457,659		3.
Exercised	—	(30,046)		4.
Canceled	1,567,159	(1,567,159)		7.335
Repurchased	5,625	—		—
Balances as of December 31, 2001	1,784,717	2,999,473		2.982
Authorized	666,667	—		—
Granted	(1,770,143)	1,770,143		4.090
Exercised	—	(441,083)		2.969
Canceled	228,003	(228,003)		3.649
Repurchased	1,729	—		
Balances as of December 31, 2002	910,973	4,100,530	$	3.424
Options exercisable as of December 31:				
2000		185,684	$	3.750
2001		918,252	$	2.937
2002		1,288,533	$	2.980

As of December 31, 2002, the range of exercise prices and weighted-average remaining contractual life of outstanding options were as follows:

	Options Outstanding				Options Exercisable		
Exercise Prices	Number of Options	Weighted-Average Remaining Contractual Life (Years)		Weighted-Average Exercise Prices	Number of Options		Weighted-Average Exercise Prices
$0.15 to $0.33	44,987	5.17	$	0.15	44,987	$	0.15
$3.00	3,703,101	8.62	$	3.00	1,228,213	$	3.00
$6.00	182,992	9.25	$	6.00	10,333	$	6.00
$8.97 to $13.99	169,450	9.74	$	10.77	5,000	$	13.50
	4,100,530				1,288,533	$	2.98

Footnote 8 – Income Taxes

Reconciles Books to Taxes

Income tax expense differed from the amounts computed by applying the U.S. federal income tax rate of 34% to pretax loss as a result of the following:

	Year Ended December 31, 2000	2001	2002
pected tax benefit at U.S. federal statutory rate of 34%	$ (19,503)	$ (13,130)	$ (7,463)
rrent year net operating loss for which no tax benefit is ognized	16,574	11,330	4,105
ck-based compensation	2,957	1,864	3,343
ner	(28)	(64)	15
tal income tax expense	$ —	$ —	$ —

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 31, 2001 and 2002, are presented below:

	As of December 31, 2001	2002
Deferred tax assets:		
Net operating loss carryforwards	$ 32,626	$ 34,270
Accruals and reserves	13,885	10,880
Other	20	80
Gross deferred tax assets	46,531	45,230
Less valuation allowance	(46,531)	(45,230)
Net deferred tax assets	$ —	$ —

Valuation Allowance

Management has established a valuation allowance for the portion of deferred tax assets for which realization is uncertain. The total valuation allowance for the years ended December 31, 2001 and 2002 increased $12,713 and decreased $1,301, respectively.

As of December 31, 2002, the Company had net operating loss carry forwards for federal and California income tax purposes of approximately $88,317 and $56,985, respectively, to reduce future income subject to

NOL

Footnote 9 (Aspen) – Segment Reporting

(19) Segment and Geographic Information

The Company follows the provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and related Information," which establishes standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports issued to stockholders. It also established standards for disclosures about products and services, and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the Chief Executive Officer of the Company.

The Company is organized geographically and by line of business. The Company has three major line of business operating segments: license, consulting services and maintenance and training. The Company also evaluates certain subsets of business segments by vertical industries as well as by product categories. While the Executive Management Committee evaluates results in a number of different ways, the line of business management structure is the primary basis for which it assesses financial performance and allocates resources.

The license line of business is engaged in the development and licensing of software. The consulting services line of business offers implementation, advanced process control, real-time optimization and other consulting services in order to provide its customers with complete solutions. The maintenance and training line of business provides customers with a wide range of support services that include on-site support, telephone support, software updates and various forms of training on how to use the Company's products.

The accounting policies of the line of business operating segments are the same as those described in the summary of significant accounting policies. The Company does not track assets or capital expenditures by operating segments. Consequently, it is not practical to show assets, capital expenditures, depreciation or amortization by operating segments.

Footnote 9 (Aspen) – Segment Reporting (cont.)

Product/Service Lines (also Markets?)

The following table presents a summary of operating segments (in thousands):

	License	Consulting Services	Maintenance and Training	Total
d June 30, 2000 —				
Revenues from unaffiliated customers	$ 132,843	$ 91,133	$ 44,117	$ 268,093
Controllable expenses	46,315	69,343	10,757	126,415
Controllable margin(1)	$ 86,528	$ 21,790	$ 33,360	$ 141,678
d June 30, 2001 —				
Revenues from unaffiliated customers	$ 147,448	$ 122,821	$ 56,655	$ 326,924
Controllable expenses	55,059	88,860	13,438	157,357
Controllable margin(1)	$ 92,389	$ 33,961	$ 43,217	$ 169,567
d June 30, 2002 —				
Revenues from unaffiliated customers	$ 133,913	$ 127,719	$ 58,972	$ 320,604
Controllable expenses	60,869	90,421	11,602	162,892
Controllable margin(1)	$ 73,044	$ 37,298	$ 47,370	$ 157,712

Geographic

Geographic Information:

Domestic and export sales as a percentage of total revenues are as follows:

	Years Ended June 30, 2000	2001	2002
United States	54.6%	51.2%	54.2%
Europe	27.5	27.7	28.4
Japan	4.8	5.3	5.1
Other	13.1	15.8	12.3
	100.0%	100.0%	100.0%

Axio

The 10K

Dissecting the Annual Reports, 10k's and Narratives

Part I

		What	Reading between the Lines
The Business	**1**	General background of what the company does, what industry it competes in and how it fits in market place. Includes a strategy discussion	This is first opportunity for management to sell you on their "importance" in the market. Most interesting are discussions of "strategy," "competition," and "risk factors"
Properties	**2**	Tells you where the companies physical assets are located	Look to see where management is located vis-à-vis business operations
Legal Proceedings	**3**	Existing litigation to which company is a party	
Submissions of Matters to Vote	**4**		

Axiomate

Part I – The Business

Forward-Looking Statements

This annual report contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements include statements regarding: our plans to open additional distribution centers in 2003; marketing expenses; technology and development expense; future stock-based compensation expense; our short-term investment strategy; international expansion; the ability of our recommendation service to accurately predict subscriber preferences; and customer acquisition and retention. These forward-looking statements are subject to risks and uncertainties described under the caption "Risks Related to Our Business" which could cause actual results to materially differ.

Axiomate

Dissecting the Annual Reports, 10K, and Narratives

- The Business (general sub-topics):
  - The Business
  - Industry Background
  - Company Advantage
  - Strategy
  - Products & Services
  - Strategic Partnerships
  - Customers
  - Sales and Marketing
  - Competition
  - Intellectual Property (IP)
  - Employees

Risk Factors

Factors that May Affect future Results of Operations

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

Axiomate

Risk Factors - Business

- "We have a limited operating history and history of net losses, and we may experience net losses in the future."
- "If we are unable to effectively utilize our recommendation service, our business may suffer."
- "If we are not able to manage our growth, our business could be affected adversely."
- "We depend on studios to release titles on DVD for an exclusive time period following theatrical release."'
- "We may need additional capital, and we cannot be sure that additional financing will be available."

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Risk Factors – Business – Red Letter Ed.

- “Increases in the cost of delivering DVDs could adversely affect our gross profit and marketing expenses.”
- “We depend on studios to release titles on DVD for an exclusive time period following theatrical release.”
- “If disposable DVDs are adopted and supported as a method of content delivery by the studios, our business could be adversely affected.”
- “If we are unable to offset increased demand for titles with increased subscriber retention or operating margins, our operating results may be affected adversely.”
- “If we are unable to renegotiate our revenue sharing agreements when they expire on terms favorable to us, or if the cost to us of purchasing titles on a wholesale basis increases, our gross margins may be affected adversely.”

Axiomate

Risk Factors – Business – Not quite comical

- "If we experience delivery problems or if our subscribers or potential subscribers lose confidence in the U.S. mail system, we could lose subscribers, which could adversely affect our operating results."
- "If we are unable to compete effectively, our business will be affected adversely."
- "Our reputation and relationships with subscribers would be harmed if our billing data were to be accessed by unauthorized persons."
- "If consumer adoption of DVD players slows, our business could be adversely affected."
- "Our executive offices and San Jose-based shipping center are located in the San Francisco Bay area. In the event of an earthquake, other natural or man-made disaster or power loss, our operations would be affected adversely."
- "The loss of one or more of our key personnel, or our failure to attract, assimilate and retain other highly qualified personnel in the future, could seriously harm our existing business and new service developments. "

Risk Factors – Stock Ownership

- "Our officers and directors and their affiliates will exercise significant control over Netflix."
- "Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable."
- "Our stock price is volatile."
- "We will record substantial expenses related to our issuance of stock options that may have a material negative impact on our operating results for the foreseeable future."
- "Financial forecasting by us and financial analysts who may publish estimates of our financial results will be difficult because of our limited operating history, and our actual results may differ from forecasts."

Item 3 – Legal Proceedings

By letter of June 7, 2002, the FTC informed us that it was conducting an investigation into the competitive effects of our recent acquisition of Hyprotech. Because the acquisition did not meet threshold requirements for pre-merger clearance under the Hart Scott Rodino Act, the FTC had not conducted any pre-merger review of the transaction. After we supplied initial background information, the FTC on September 12, 2002 issued a document subpoena and a Civil Investigative Demand to obtain written answers to certain questions about the acquisition and its impact on competition. The response date for the subpoena and the CID is October 15, 2002, although we understand that we will be allowed additional time so long as we are fully engaged in responding by that date. We are cooperating fully in the investigation and currently are working to complete production of the requested information.

Because this investigation is in its early stages, we cannot be certain whether the FTC might seek any relief from us or the nature of any such relief that might be sought. The FTC may determine to challenge the acquisition through an administrative civil complaint seeking to declare the acquisition in violation of Section 7 of the Clayton Act or Section 5 of the FTC Act. If the FTC were to prevail in that challenge, it could seek to impose a wide variety of remedies, some of which may have a material adverse effect on our ability to continue to operate under our current business plans. These potential remedies include divestiture of Hyprotech, as well as mandatory licensing of Hyprotech software products and our other engineering software products to one or more of our competitors.

Dissecting the Annual Reports, 10k's and Narratives

Part II

		What	Reading between the Lines
Market for Registrant's Common Stock	**5**	Market data on the company's common stock including: High/Lows by quarter, number of holder, recent sales of unregistred shares	Understand how broadly traded and volatile stock is. Note recent shares of unregistered sales (acquisitions.) If used to raise money, company could be in trouble
Selected Financial Data	**6**	Summarized financial results	Management has a little lattitude to present information in non-GAAP format
Management's Discussion and Analysis (MD&A)	**7**	Management's narrative of the year in review. It is far more extensive and informative than is found in standard financial statements	MDA is largely structured as changes in accounts must be noted in dollars and percentages. However, management controls the verbage, hence the spin. Though MD&A is more structured in the glossy annual report, you may nonetheless find shallow excuses such as blaming the war. Liquidity and capital resources are most interesting!
Financial Statements and Supplementary Data	**8**	Generally financial statements, incorporated by reference	
Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	**9**	Documents problems or disagreements with auditors	Any auditor change should cause one to pause

Axiomate

MD&A – Understanding the Business Model

Revenue

Revenues

We derive substantially all of our revenues from monthly subscription fees. From the launch of our Web site in April 1998 through January 1999, we generated revenues primarily from individual DVD rentals and sales to customers. In March 1999, we stopped selling new DVDs. From February 1999 through October 1999, we generated revenues primarily from individual DVD rentals to customers. In September 1999, we launched our subscription service, and through February 2000, for a fixed monthly subscription fee of $15.95, subscribers could have up to four titles per month with no due dates or late fees, and for $3.98, could order an additional title. In February 2000, we modified our standard subscription service to provide subscribers access to an unlimited number of titles for $19.95 per month, with a maximum of four titles out at any time. Existing subscribers were switched to our new service, some at $15.95 per month and the rest at $19.95 per month. In October 2000, we again modified our standard subscription service to provide subscribers access to an unlimited number of titles for a fixed monthly fee, with a maximum of three titles out at the same time. There is no minimum subscription period and subscribers can cancel our service at any time.

Axiomate

MD&A – Understanding the Business Model

Cost of Revenue

Cost of Revenues

Cost of Subscription Revenues

We acquire titles for our library using traditional buying methods and revenue sharing agreements. Traditional buying methods normally result in higher upfront costs when compared to titles obtained through revenue sharing agreements. Cost of subscription revenues consists of revenue sharing costs, amortization of our library, amortization of intangible assets related to equity instruments issued to certain studios and postage and packaging costs related to shipping titles to paying subscribers.

Revenue sharing costs . Our revenue sharing agreements generally commit us to pay an initial upfront fee for each DVD acquired. Revenue sharing expense is recorded as DVD's subject to revenue sharing agreements are shipped to subscribers. Under certain of our revenue sharing agreements, we pay an additional minimum revenue sharing fee for each DVD shipped to a subscriber. Other than the initial upfront payment for DVD's acquired, we are not obligated to pay any minimum revenue sharing fee on DVDs that are not shipped to subscribers. We characterize these payments to the studios as revenue sharing costs. As of December 31, 2002, we had revenue sharing agreements with over 50 studios.

Amortization of the cost of DVDs . On January 1, 2001, we revised the estimated life to one year and assumed a salvage value of $2.00 for the DVDs that we believe we will eventually sell. Prior to January 1, 2001, we amortized our cost of DVDs using an accelerated method over an estimated life of three years and assumed no salvage value.

MD&A – Unique Items

"Strategic Incentives"

Amortization of intangible assets related to equity issued to studios . In 2000, in connection with signing revenue sharing agreements with Columbia TriStar Home Entertainment, Dreamworks International Distribution and Warner Home Video, we agreed to issue each of these studios an amount of our Series F Non-Voting Preferred Stock equal to 1.204% of our fully diluted equity securities outstanding. In 2001, in connection with signing revenue sharing agreements with Twentieth Century Fox Home Entertainment and Universal Studios Home Video, we agreed to issue to each of the two studios an amount of our Series F Non-Voting Preferred Stock equal to 1.204% of our fully diluted equity securities outstanding. As of December 31, 2001, the aggregate of Series F Non-Voting Preferred Stock granted to these five studios equaled 6.02% of our fully diluted equity securities outstanding. Our obligation to maintain the studios' equity interests at 6.02% of our fully diluted equity securities outstanding terminated immediately prior to our initial public offering. The studios' Series F Preferred Stock automatically converted into 1,596,415 shares of common stock upon the closing of our initial public offering. We measured the original issuances and any subsequent adjustments using the fair value of the securities at the issuance and any subsequent adjustment dates. The fair value was recorded as an intangible asset

MD&A – Unique Items

Stock-based Compensation

Stock-Based Compensation

Stock-based compensation for equity instruments issued to employees represents the aggregate difference, at the grant date, between the respective exercise price of stock options or stock grants and the fair market

For each hypothetical one-dollar increase or decrease in the fair value of our common stock, we will record deferred compensation in an amount equal to the number of shares underlying the variable awards multiplied by the one-dollar change. However, to the extent these variable awards are not fully vested, our stock compensation expense will be less than the amount we record as deferred compensation. For example, if at December 31, 2002 the fair value of our common stock had increased or decreased by $1.00, our deferred stock-based compensation would change by approximately $0.6 million and our stock-based compensation expense would be affected by approximately $0.3 million. Once these variable awards become fully vested, our stock based compensation will be affected on a dollar-for-dollar basis and a change in our stock price will directly impact the amount we record as stock-based compensation in an amount equal to the number of shares underlying the variable awards outstanding multiplied by the change in the fair value of our common stock. For example, assuming all 635,000 exchanged options are fully vested and outstanding and assuming an increase or decrease in the fair value of our common stock of $1.00 in a quarter, our stock-based compensation expense or credit related to the variable awards for that quarter would be $0.6 million. As of December 31, 2002, most of these variable awards were not fully vested and had a variety of final vesting dates over the next two years.

change in our stock price will directly impact the amount we record as stock-based compensation in an amount equal to the number of shares underlying the variable awards outstanding multiplied by the change in the fair value of our common stock. For example, assuming all 635,000 exchanged options are fully vested and outstanding and assuming an increase or decrease in the fair value of our common stock of $1.00 in a quarter, our stock-based compensation expense or credit related to the variable awards for that quarter would be $0.6 million. As of December 31, 2002, most of these variable awards were not fully vested and had a variety of final vesting dates over the next two years.

Axi

MD&A – Liquidity and Capital Resources

Since inception, we have financed our activities primarily through a series of private placements of convertible preferred stock, subordinated promissory notes and our initial public offering. As of December 31, 2002, we had cash and cash equivalents of $59.8 million and short-term investments of $43.8 million. Although we currently anticipate that the proceeds from our May 2002 public offering, together with our available funds and cash flow from operations, will be sufficient to meet our cash needs for the foreseeable future, we may require additional financing. Our ability to obtain financing will depend, among other things, on our … markets at the … us on favorable … equity-linked … rights of our co… Business" and …

Net cash used i… was $4.8 millio… primarily attrib… partially offset … expenses, incre… operating activ… expenses and a… attributable pri… than operating … increase in non… a $9.3 million i… DVDs.

Net cash provided by financing activities was $48.4 million in 2000, $9.1 million in 2001 and $70.9 million in 2002. Net cash provided by financing activities in 2000 was primarily attributable to proceeds from the sale of our Series E Convertible Preferred Stock, partially offset by payments on notes payable and capital lease obligations. Net cash provided by financing activities in 2001 was primarily attributable to proceeds from the sale of common stock warrants and subordinated promissory notes, partially offset by payments on notes payable and capital lease obligations. Net cash provided by financing activities in 2002 was attributable primarily to proceeds from the sale of our common stock in our initial public offering that raised net proceeds of $86.2 million, partially offset by the repayment of $14.2 million on our subordinated notes payable and $2.9 million on our other notes payable and capital lease obligations.

Net cash used in investing activities was $25.0 million in 2000, $12.7 million in 2001 and $67.3 million in 2002. Net cash used in investing activities in 2000 was primarily attributable to our acquisition of titles for our library and property and equipment, partially offset by proceeds from the sale of short-term investments. Net cash used in investing activities in 2001 was primarily attributable to our acquisition of titles for our library and property and equipment. The 63% decrease in cash used to acquire DVDs in 2001 from 2000, primarily reflects the reduced cash requirements to acquire DVDs under our revenue sharing agreements. Net cash used in investing activities in 2002 was attributable primarily to a $43.0 million purchase of short-term investments with a portion of our initial public offering proceeds and $24.1 million related to the acquisition of titles for our DVD library. While DVD acquisition expenditures are classified as cash flows from investing activities you may wish to consider these together with cash flows from operating activities.

Net cash provided by financing activities was $48.4 million in 2000, $9.1 million in 2001 and $70.9 million in 2002. Net cash provided by financing activities in 2000 was primarily attributable to proceeds from the sale of our Series E Convertible Preferred Stock, partially offset by payments on notes payable and capital lease obligations. Net cash provided by financing activities in 2001 was primarily attributable to proceeds from the sale of common stock warrants and subordinated promissory notes, partially offset by payments on notes payable and capital lease obligations. Net cash provided by financing activities in 2002 was attributable primarily to proceeds from the sale of our common stock in our initial public offering that raised net proceeds of $86.2 million, partially offset by the repayment of $14.2 million on our subordinated notes payable and $2.9 million on our other notes payable and capital lease obligations.

A… Inc.

"In essence, verbal explanation of cash balance and cash flow"

MD&A – Restructuring Charges

Restructuring and Other Charges. During fiscal 2002, management undertook two separate restructuring plans. The first occurred in August 2001 and amounted to $2.6 million, primarily related to severance. The second occurred in May 2002 and amounted to $14.4 million, related to severance, facility consolidations and the write-off of certain assets. In addition, during fiscal 2002, we revised estimates on previously recorded restructuring plans, resulting in a reversal of an aggregate $1.1 million of facility accruals and a $0.1 million increase to a severance settlement.

August 2001 restructuring plan. During August 2001, in light of economic uncertainties, management made a decision to adjust the business plan by reducing spending, which resulted in a restructuring charge of $2.6 million, primarily for severance. Approximately 100 employees, or 5% of the workforce, were eliminated under the changes to the business plan implemented by management. Areas impacted included sales and marketing, services, research and development, and general and administrative.

May 2002 restructuring plan. In the third quarter of fiscal 2002, revenues were lower than our expectations as customers delayed spending due to the general weakness in the economy. Like many other software companies, we reduced our revenue expectations for the fourth quarter and for the fiscal year 2003. Based upon the impact of these reduced revenue expectations, management evaluated our current business and made significant changes, resulting in a restructuring plan for our operations. This restructuring plan included a reduction in headcount, tighter cost controls, the close-down and consolidation of facilities, and the write-off of certain assets.

Axiomate

"Another Risk Factor – This Management Team"

Axiomate, Inc.

Item 7A - *Quantitative and Qualitative Disclosures about Market Risk*

Impact of Foreign Currency Rate Changes

During fiscal 2002, the U.S. dollar weakened against currencies for countries in which we have local operations, primarily in Europe and the Asia-Pacific region. The translation of our foreign entities' assets and liabilities did not have a material impact on our consolidated operating results. Foreign exchange forward contracts are only purchased to hedge certain customer installments receivable amounts denominated in a foreign currency. The revaluation of accounts receivable at our foreign locations and at Hyprotech for the month of June, that were denominated in currencies other than the local currencies, resulted in net losses totaling $2.3 million in fiscal 2002. These losses were partially offset by the revaluation of two short-term loans from our U.S. headquarters to our foreign subsidiaries that were denominated in foreign currencies. These two loans were issued in May 2002, and were revalued as of June 30, 2002, resulting in an aggregate gain of $1.2 million.

Foreign Exchange Hedging

We enter into foreign exchange forward contracts to reduce our exposure to currency fluctuations on customer installments receivable denominated in foreign currencies. The objective of these contracts is to limit the impact of foreign currency exchange rate movement on our operating results. We do not use derivative financial instruments for speculative or trading purposes. We had $8.5 million of foreign exchange forward contracts denominated in Japanese, British, Swiss, Singapore and Euro currencies which represented underlying customer installments receivable transactions at the end of fiscal 2002. We adopted SFAS No. 133 in the first quarter of fiscal 2001. As a result, at each balance sheet date, the foreign exchange forward contracts and the related installments receivable denominated in foreign currencies are revalued based on the current market exchange rates. Resulting gains and losses are included in earnings or deferred as a component of other comprehensive income. These deferred gains and losses are recognized in income in the period in which the underlying anticipated transaction occurs. Gains and losses related to these instruments for fiscal 2002 were not material to our financial position. We do not anticipate any material adverse effect on our consolidated financial position, operating results or cash flows resulting from the use of these instruments. There can be no assurance, however, that these strategies will be effective or that transaction losses can be limited or forecasted accurately.

Dissecting the Annual Reports, 10k's and Narratives

Part III

		What	Reading between the Lines
Directors and Executive Officers of the Registrant	**10**	Table listing officers and directors, ages and bios	Look for directors that can contribute AND have some degree of independence
Executive Compensation	**11**	Table listing salary, bonus and stock options of executives	Look for reasonableness of executive compensation; look for alignment of interests
Security Ownership of Certain Beneficial Owners	**12**	Table showing direct and indirect ownership of all classes of stock of directors and officers	Look to find the real power of the company
Certain Relationships and Related Parties	**13**	Disclosure of transactions with officers, directors, and affiliated companies	Look for less than arms length dealings, potential for dependance
Controls & Procedures	**14**		

Axiomate

Nothing New

New

CERTIFICATIONS UNDER SECTION 302 OF SARBANES/OXLEY ACT

I, Joan S. Hooper, certify that:

1. I have reviewed this annual report on Form 10-K of FreeMarkets, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant, and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls that could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that

Axiomate

Exhibits

)f Incorporation of Aspen Technology, Inc.
Aspen Technology, Inc.
Certificate for Shares of Aspen Technology, Inc.'s common stock, $.10 par value.
eement dated as of March 12, 1998 between Aspen Technology, Inc. and American Stock Transfer and Trust Company,
gent, including related forms of the following: (a) Certificate of Designation of Series A Participating Cumulative
tock of Aspen Technology, Inc.; and (b) Right Certificate.
t No. 1 dated as of October 26, 2001 to Rights Agreement dated as of March 12, 1998 between Aspen Technology, Inc.
an Stock Transfer & Trust Company, as Rights Agent.
t No. 2 dated as of February 6, 2002 to Rights Agreement dated as of March 12, 1998 between Aspen Technology, Inc.
an Stock Transfer & Trust Company.
t No. 3 dated as of March 19, 2002 to Rights Agreement dated as of March 12, 1998 between Aspen Technology, Inc.
an Stock Transfer & Trust Company.
t No. 4 dated as of May 9, 2002 to Rights Agreement dated as of March 17, 1998 between Aspen Technology, Inc. and
tock Transfer & Trust Company, as Rights Agent.
ated as of June 17, 1998 between Aspen Technology, Inc. and The Chase Manhattan Bank, as trustee, with respect to up
000 principal amount of 5 1/4% Convertible Subordinated Debentures due June 15, 2005 of Aspen Technology, Inc.

Axiomate

Signatures

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Netflix, Inc.	
n 28, 2003	By:	/s/ R EED H ASTINGS
		Reed Hastings
		Chief Executive Officer
		(principal executive officer)
n 28, 2003	By:	/s/ B ARRY M C C ARTHY
		Barry McCarthy
		Chief Financial Officer
		(principal financial and accounting officer)

Current Trends

- ***Sarbanes – Oxley***
- ***FASB / SEC Pressure***
- ***Shareholder Suits***

Sarbanes-Oxley Act of 2002

- Reporting
  - Upgrade disclosures
- Roles
  - Strengthen corporate governance
- Conduct
  - Expand insider accountability
- Enforcement
  - Increase Oversight
- Penalties
  - Broaden Sanctions
- Relationships
  - Re-establish auditor independence

Reporting

- **Sec 404 – Evaluation of Internal Control**
  - Management must annually self-assess I/C

- Sec 401 - Off Balance Sheet & Proforma Disclosures
  - Enhances disclosures of off balance sheet items
- Sec 404 – Evaluation of Internal Control
  - Management must annually self-assess I/C
- Sec 409 - Real Time Issuer Disclosures
  - Rapid and current disclosures of sudden changes

Understanding Business Processes

- What events within the business have financial consequence?
  - Classify types of transacations
    - Production cycle; sales cycle; receipt cycle; disbursement cycle; finance cycle; capital cycle
  - Identify all types of transactions within a business
    - Routine v. non-routine;
    - Volume of transaction;
    - degree of judgment applied to valuation
    - Liquidity of underlying asset
  - Identify risks within process
    - What can go wrong?
    - Impact if it goes wrong?

Additional Resources

- Analysis / Information Sites
  - Hoovers *www.hoovers.com*
  - Edgar *www.sec.gov*
  - AICPA *www.aicpa.org*
  - RMA *www.rmahq.org*
- Books
  - Corporate Controllers Handbook of Financial Management
  - The Portable MBA in Finance and Accounting
  - Lorman Bookstore *www.lorman.com*

Thank You!