amazon.com

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

We will continue to focus relentlessly on our customers.

- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.

- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.

- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.

- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.

- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.

- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click(SM) shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million -- an 838% increase.

- Cumulative customer accounts grew from 180,000 to 1,510,000 -- a 738% increase.

- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.

- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.

- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.

- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.

- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.

- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, “You can work long, hard, or smart, but at Amazon.com you can't choose two out of three”), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

/s/ JEFFREY P. BEZOS
Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareholders, customers, and employees:

The last 3½ years have been exciting. We've served a cumulative 6.2 million customers, exited 1998 with a $1 billion revenue run rate, launched music, video, and gift stores in the U.S., opened shop in the U.K. and Germany, and, just recently, launched Amazon.com Auctions.

We predict the next 3½ years will be even more exciting. We are working to build a place where tens of millions of customers can come to find and discover anything they might want to buy online. It is truly Day 1 for the Internet and, if we execute our business plan well, it remains Day 1 for Amazon.com. Given what's happened, it may be difficult to conceive, but we think the opportunities and risks ahead of us are even greater than those behind us. We will have to make many conscious and deliberate choices, some of which will be bold and unconventional. Hopefully, some will turn out to be winners. Certainly, some will turn out to be mistakes.

A Recap of 1998

Heads-down focus on customers helped us make substantial progress in 1998:

- Sales grew from $148 million in 1997 to $610 million – a 313% increase.
- Cumulative customer accounts grew from 1.5 million at the end of 1997 to 6.2 million at the end of 1998 – an increase of over 300%.
- Despite this strong new customer growth, the percentage of orders placed on the Amazon.com Web site by repeat customers grew from over 58% in the fourth quarter of 1997 to over 64% in the same period in 1998.
- Our first major product expansion, the Amazon.com music store, became the leading online music retailer in its first full quarter.
- Following their October launch under the Amazon brand and with Amazon.com technology, the combined fourth-quarter sales in the U.K. and German stores nearly quadrupled over the third quarter, establishing Amazon.co.uk and Amazon.de as the leading online booksellers in their markets.
- The addition of music was followed by the addition of video and gifts in November, and we became the leading online video retailer in only 6 weeks.
- 25% of our fourth-quarter 1998 sales was derived from Amazon.co.uk, Amazon.de, and music, video, and gift sales on Amazon.com, all very new businesses.
- We significantly improved the customer experience, with innovations like 1-Click℠ shopping, Gift Click, store-wide sales rank, and instant recommendations.

1998's revenue and customer growth and achievement of continued growth in 1999 were and are dependent on expansion of our infrastructure. Some highlights:

- In 1998 our employee base grew from approximately 600 to over 2,100, and we significantly strengthened our management team.
- We opened distribution and customer service centers in the U.K. and Germany, and in early 1999, announced the lease of a highly-mechanized distribution center of approximately 323,000 square feet in Fernley, Nevada. This latest addition will more than double our total distribution capacity and allows us to even further improve time-to-mailbox for customers.
- Inventories rose from $9 million at the beginning of the year to $30 million by year end, enabling us to improve product availability for our customers and improve product costs through direct purchasing from manufacturers.
- Our cash and investment balances, following our May 1998 high yield debt offering and early 1999 convertible debt offering, now stand at well over $1.5 billion (on a pro forma basis), affording us substantial financial strength and strategic flexibility.

We're fortunate to benefit from a business model that is cash-favored and capital efficient. As we do not need to build physical stores or stock those stores with inventory, our centralized distribution model has allowed us to build our business to a billion-dollar sales rate with just $30 million in inventory and $30 million in net plant and equipment. In 1998, we generated $31 million in operating cash flow which more than offset net fixed asset additions of $28 million.

Our Customers

We intend to build the world's most customer-centric company. We hold as axiomatic that customers are perceptive and smart, and that brand image follows reality and not the other way around. Our customers tell us that they choose Amazon.com and tell their friends about us because of the selection, ease-of-use, low prices, and service that we deliver.

But there is no rest for the weary. I constantly remind our employees to be afraid, to wake up every morning terrified. Not of our competition, but of our customers. Our customers have made our business what it is, they are the ones with whom we have a relationship, and they are the ones to whom we owe a great obligation. And we consider them to be loyal to us – right up until the second that someone else offers them a better service.

We must be committed to constant improvement, experimentation, and innovation in every initiative. We love to be pioneers, it's in the DNA of the company, and it's a good thing, too, because we'll need that pioneering spirit to succeed. We're proud of the differentiation we've built through constant innovation and relentless focus on customer experience, and we believe our initiatives in 1998 reflect it: our music, video, U.K. and German stores, like our U.S. bookstore, are best of breed.

Work Hard, Have Fun, Make History

It would be impossible to produce results in an environment as dynamic as the Internet without extraordinary people. Working to create a little bit of history isn't supposed to be easy, and, well, we're finding that things are as they're supposed to be! We now have a team of 2,100 smart, hard-working, passionate folks who put customers first. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

During our hiring meetings, we ask people to consider three questions before making a decision:

- *Will you admire this person?* If you think about the people you've admired in your life, they are probably people you've been able to learn from or take an example from. For myself, I've always tried hard to work only with people I admire, and I encourage folks here to be just as demanding. Life is definitely too short to do otherwise.

- *Will this person raise the average level of effectiveness of the group they're entering?* We want to fight entropy. The bar has to continuously go up. I ask people to visualize the company 5 years from now. At that point, each of us should look around and say, "The standards are so high now -- boy, I'm glad I got in when I did!"

- *Along what dimension might this person be a superstar?* Many people have unique skills, interests, and perspectives that enrich the work environment for all of us. It's often something that's not even related to their jobs. One person here is a National Spelling Bee champion (1978, I believe). I suspect it doesn't help her in her everyday work, but it does make working here more fun if you can occasionally snag her in the hall with a quick challenge: "onomatopoeia!"

Goals for 1999

As we look forward, we believe that the overall e-commerce opportunity is enormous, and 1999 will be an important year. Although Amazon.com has established a strong leadership position, it is certain that competition will even further accelerate. We plan to invest aggressively to build the foundation for a multi-billion-dollar revenue company serving tens of millions of customers with operational excellence and high efficiency. Although this level of forward investment is costly and carries many inherent risks, we believe it will provide the best end-to-end experience for customers, and actually offer the least risky long-term value creation approach for investors.

The elements of our 1999 plan may not surprise you:

Distribution capacity – We intend to build out a significant distribution infrastructure to ensure that we can support all the sales our customers demand, with speedy access to a deep product inventory.

Systems capacity – We'll be expanding our systems capacity to support similar growth levels. The systems group has a significant task: expand to meet near term growth, restructure systems for multi-billion dollar scale and tens of millions of customers, build out features and systems for new initiatives and new innovations, and increase operational excellence and efficiency. All while keeping a billion dollar, 8 million customer store up and available on a 24x7 basis.

Brand promise – Amazon.com is still a small and young company relative to the major offline retailers, and we must ensure that we build wide, strong customer relationships during this critical period.

Expanded product and service offerings – In 1999, we will continue to enhance the scope of our current product and service offerings, as well as add new initiatives. Amazon.com Auctions is our most recent addition. If any of you have not tried this new service, I encourage you to run – not walk – to www.amazon.com and click on the Auctions tab. As an Amazon.com customer, you are pre-registered to both bid and sell. As a seller, you have access to Amazon.com's 8 million experienced online shoppers.

Bench strength and processes – We've complicated our business dramatically with new products, services, geographies, acquisitions and additions to our business model. We intend to invest in teams, processes, communication and people development practices. Scaling in this way is among the most challenging and difficult elements of our plan.

Amazon.com has made a number of strides forward in the past year, but there is still an enormous amount to learn and to do. We remain optimistic, but we also know we must remain vigilant and maintain a sense of urgency. We face many challenges and hurdles. Among them, aggressive, capable and well-funded competition; the growth challenges and execution risk associated with our own expansion; and the need for large continuing investments to meet an expanding market opportunity.

The most important thing I could say in this letter was said in last years' letter, which detailed our long-term investment approach. Because we have so many new shareholders (this year we're printing more than 200,000 of these letters – last year we printed about 13,000), we've appended last year's letter immediately after this year's. I invite you to please read the section entitled *It's All About the Long Term*. You might want to read it twice to make sure we're the kind of company you want to be invested in. As it says there, we don't claim it's the right philosophy, we just claim it's ours!

All the best and sincere thanks once again to our customers and shareholders and all the folks here who are working passionately every day to build an important and lasting company.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

amazon.com

(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

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Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

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With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click(SM) shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

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- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.

- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.

- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.

- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.

- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.

- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.

- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

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Goals for 1998

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We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareholders:

The first 4½ years of our journey have yielded some amazing results: we've now served over 17 million customers in over 150 countries and built the leading global e-commerce brand and platform.

In the coming years we expect to benefit from the continued adoption of online commerce around the world as millions of new consumers connect to the Internet for the first time. As the online shopping experience continues to improve, consumer trust and confidence will increase, driving further adoption. And, if we at Amazon.com do our job right, we can be uniquely positioned to serve these new customers best and benefit as a result.

A Recap of 1999

During 1999, our relentless focus on customers worked:

- Sales grew from $610 million in 1998 to $1.64 billion – a 169 percent increase.
- We added 10.7 million new customers, increasing cumulative customer accounts from 6.2 million to 16.9 million.
- The percentage of orders placed by repeat customers grew from over 64 percent in the fourth quarter of 1998 to greater than 73 percent in the same period in 1999.
- Customers around the world are now choosing Amazon.com for a wide array of products. Only two years ago, Amazon.com's U.S. Books business represented 100 percent of our sales. Today, despite strong growth in U.S. Books, other areas account for more than half our sales. Major 1999 initiatives included Auctions, zShops, Toys, Consumer Electronics, Home Improvement, Software, Video Games, Payments and our wireless initiative, Amazon Anywhere.
- We've continued to be recognized as best-of-breed not only in our more established areas such as books, but in our newer stores as well. Just to focus on one area, Amazon Toys has received multiple awards, including being rated the best online toy store in an MSNBC survey, a ranking as the No. 1 on-line toy store by Forrester Research, and the top e-Rating from Consumer Reports in the toys category, in each case beating out a number of longer-established players.
- Sales outside of the US accounted for 22 percent of our business, totaling $358 million. In the U.K. and Germany, we added Music, Auctions and zShops. In fact, Amazon.co.uk, Amazon.de, and Amazon.com are now the #1, #2, and #3 most popular online retail domains in Europe.
- We grew worldwide distribution capacity from roughly 300,000 square feet to over 5 million square feet in less than 12 months.

- In part because of this infrastructure, we were able to grow revenues 90 percent in just three months, while shipping well over 99 percent of our holiday orders in time for the holidays. As far as we can determine, no other company has ever grown 90 percent in three months on a sales base of over $1 billion.

I'm incredibly proud of everyone at Amazon.com for their tireless efforts to deliver what has become the standard-setting, Amazon.com-class customer experience while simultaneously handling such extraordinary growth rates. If any of you shareholders would like to thank this incredible worldwide team of Amazonians, please feel free to send an email to jeff@amazon.com. With help from my astounding office staff, I'll compile them and send them to the company. I know it would be appreciated. (As a side benefit I'll get to see if anyone reads these letters!)

In 1999, we continued to benefit from a business model that is inherently capital efficient. We don't need to build physical stores or stock those stores with inventory, and our centralized distribution model has allowed us to build a business with over $2 billion in annualized sales but requiring just $220 million in inventory and $318 million in fixed assets. Over the last five years, we've cumulatively used just $62 million in operating cash.

What Do You Own?

At a recent event at the Stanford University campus, a young woman came to the microphone and asked me a great question: "I have 100 shares of Amazon.com. What do I own?"

I was surprised I hadn't heard it before, at least not so simply put. What do you own? You own a piece of the leading e-commerce platform.

The Amazon.com platform is comprised of brand, customers, technology, distribution capability, deep e-commerce expertise, and a great team with a passion for innovation and a passion for serving customers well. We begin the year 2000 with 17 million customers, a world-wide reputation for customer focus, the best e-commerce software systems, and purpose-built distribution and customer service infrastructure. We believe we have reached a "tipping point," where this platform allows us to launch new e-commerce businesses faster, with a higher quality of customer experience, a lower incremental cost, a higher chance of success, and a faster path to scale and profitability than any other company.

Our vision is to use this platform to build Earth's most customer-centric company, a place where customers can come to find and discover anything and everything they might want to buy online. We won't do so alone, but together with what will be thousands of partners of all sizes. We'll listen to customers, invent on their behalf, and personalize the store for each of them, all while working hard to continue to earn their trust. As is probably clear, this platform affords an unusually large scale opportunity, one that should prove very valuable for both customers and shareholders if we can make the most of it. Despite the many risks and complexities, we are deeply committed to doing so.

Goals for 2000

In the year 2000, Amazon.com has six major goals: growth in both the number of our customers and the strength of the relationship we have with each of them; continued rapid expansion of the products and services we offer; driving operational excellence in all areas of the company; international expansion; expanding our partnership programs; and last, importantly, driving toward profitability in each and every business we are in. I'll spend a moment on each goal.

Growing and strengthening customer relationships — We will continue to invest heavily in introductions to new customers. Though it's sometimes hard to imagine with all that has happened in the last five years, this remains Day 1 for e-commerce, and these are the early days of category formation where many customers are forming relationships for the first time. We must work hard to grow the number of customers who shop with us, the number of products they purchase, the frequency with which they shop, and the level of satisfaction they have when they do so.

Product and service expansion — We are working to build a place where customers can find and discover anything they want to buy, anytime, anywhere. Each new product and service we offer makes us more relevant to a wider group of customers and can increase the frequency with which they visit our store. So, as we expand our offering, we create a virtuous cycle for the whole business. The more frequently customers visit our store, the less time, energy, and marketing investment is required to get them to come back again. In sight, in mind.

Further, as we expand, each new store has a dedicated team working to make it best-of-breed in its category; thus each new store is also a new opportunity to demonstrate to customers our focus on them. Finally, each new product or service further leverages our investments in distribution, customer service, technology, and brand, and can yield increased leverage on our bottom line.

Operational excellence — To us, operational excellence implies two things: delivering continuous improvement in customer experience and driving productivity, margin, efficiency, and asset velocity across all our businesses.

Often, the best way to drive one of these is to deliver the other. For instance, more efficient distribution yields faster delivery times, which in turn lowers contacts per order and customer service costs. These, in turn, improve customer experience and build brand, which in turn decreases customer acquisition and retention costs.

Our whole company is highly focused on driving operational excellence in each area of our business in 2000. Being world class in both customer experience and operations will allow us to grow faster and deliver even higher service levels.

International expansion — We think that consumers outside the U.S. are even more under-served by retail than those within it, and, with our platform in place, Amazon.com is well positioned to be a leading global retailer. We already have significant brand, sales and customer presence around the world, as we've been shipping into over 150 countries for almost five years. I'm pleased to report that our stores in the UK and Germany are off to a strong start – they are already in the top 10 Web properties and the # 1 e-commerce site in each of their respective countries. Our customers and shareholders around the world can look forward to further geographic expansion from this base during the coming year.

Expanding our partnership program — Through our platform, we are able to bring tremendous value to our partners, such as drugstore.com. In fact, our experience so far suggests that Amazon.com may easily be the most efficient, effective means for our partners to build their businesses. In many areas, partnering is the best way for us to rapidly expand our store in a customer-focused, cost-effective manner. One point worth emphasizing: the quality of customer experience a partner delivers is the single most important criteria in our selection process – we simply won't build a partnership with any company that does not share our passion for serving customers.

We love these kinds of partnerships because they please customers, please our partners, and are financially attractive, pleasing our shareholders – you and us.

Drive toward profitability in each business we are in — Each of the previous goals I've outlined contribute to our long-standing objective of building the best, most profitable, highest return on capital, long-term franchise. So in a way, driving profitability is the foundation underlying all of these goals. In the coming year, we expect to deliver substantial margin improvement and cost leverage as we drive continuous improvement in our partnerships with suppliers, in our own productivity and efficiency, in our management of fixed and working capital, and our expertise in managing product mix and price.

Each successive product and service we launch this year should build on our platform, so our investment curve can be less steep and the time to profitability for each business should, in general, continue to shorten.

It's All About the Long Term

In our 1997 letter to shareholders (our first), we detailed our long-term investment approach. Because we continue to add many new shareholders, we've appended that letter immediately after this year's.   I invite you to please read the section entitled *It's All About the Long Term*, as it is the best way I know to help make sure we're the kind of company you want to be invested in. As we wrote there, we don't claim it's the right philosophy, we just claim it's ours!

In closing, consider this most important point: the current online shopping experience is the worst it will ever be. It's good enough today to attract 17 million customers, but it will get so much better. Increased bandwidth will result in faster page views and richer content. Further improvements will lead to "always-on access" (which I expect will be a strong boost to online shopping at home, as opposed to the office) and we'll see significant growth in non-PC devices and wireless access. Moreover, it's great to be participating in what is a multi-trillion dollar global market, in which we are so very, very tiny. We are doubly-blessed. We have a market-size unconstrained opportunity in an area where the underlying foundational technology we employ improves every day. That is <u>not</u> normal.

As always, we at Amazon.com remain grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement. Many, many thanks.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.

- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.

- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.

- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.

- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.

- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.

- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click(SM) shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.

- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.

- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.

- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.

- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, “You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareholders:

Ouch. It's been a brutal year for many in the capital markets and certainly for Amazon.com shareholders. As of this writing, our shares are down more than 80% from when I wrote you last year. Nevertheless, by almost any measure, Amazon.com the company is in a stronger position now than at any time in its past.

- We served 20 million customers in 2000, up from 14 million in 1999.
- Sales grew to $2.76 billion in 2000 from $1.64 billion in 1999.
- Pro forma operating loss shrank to 6% of sales in Q4 2000, from 26% of sales in Q4 1999.
- Pro forma operating loss in the U.S. shrank to 2% of sales in Q4 2000, from 24% of sales in Q4 1999.
- Average spend per customer in 2000 was $134, up 19%.
- Gross profit grew to $656 million in 2000, from $291 million in 1999, up 125%.
- Almost 36% of Q4 2000 U.S. customers purchased from one of our ''non-BMV'' stores such as electronics, tools, and kitchen.
- International sales grew to $381 million in 2000, from $168 million in 1999.
- We helped our partner Toysrus.com sell more than $125 million of toys and video games in Q4 2000.
- We ended 2000 with cash and marketable securities of $1.1 billion, up from $706 million at the end of 1999, thanks to our early 2000 euroconvert financing.
- And, most importantly, our heads-down focus on the customer was reflected in a score of 84 on the American Customer Satisfaction Index. We are told this is the highest score ever recorded for a service company in any industry.

So, if the company is better positioned today than it was a year ago, why is the stock price so much lower than it was a year ago? As the famed investor Benjamin Graham said, ''In the short term, the stock market is a voting machine; in the long term, it's a weighing machine.'' Clearly there was a lot of voting going on in the boom year of '99—and much less weighing. We're a company that wants to be weighed, and over time, we will be—over the long term, all companies are. In the meantime, we have our heads down working to build a heavier and heavier company.

Many of you have heard me talk about the ''bold bets'' that we as a company have made and will continue to make—these bold bets have included everything from our investment in digital and wireless technologies, to our decision to invest in smaller e-commerce companies, including living.com and Pets.com, both of which shut down operations in 2000. We were significant shareholders in both and lost a significant amount of money on both.

We made these investments because we knew we wouldn't ourselves be entering these particular categories any time soon, and we believed passionately in the ''land rush'' metaphor for the Internet. Indeed, that metaphor was an extraordinarily useful decision aid for several years starting in 1994, but we now believe its usefulness largely faded away over the last couple of years. In retrospect, we significantly underestimated how much time would be available to enter these categories and underestimated how difficult it would be for single-category e-commerce companies to achieve the scale necessary to succeed.

Online selling (relative to traditional retailing) is a scale business characterized by high fixed costs and relatively low variable costs. This makes it difficult to be a medium-sized e-commerce company. With a long enough financing runway, Pets.com and living.com may have been able to acquire enough customers to achieve the needed scale. But when the capital markets closed the door on financing Internet companies, these companies simply had no choice but to close their doors. As painful as that was, the alternative—investing more of our own capital in these companies to keep them afloat—would have been an even bigger mistake.

Future: Real Estate Doesn't Obey Moore's Law.

Let's move to the future. Why should you be optimistic about the future of e-commerce and the future of Amazon.com?

Industry growth and new customer adoption will be driven over the coming years by relentless improvements in the customer experience of online shopping. These improvements in customer experience will be driven by innovations made possible by dramatic increases in available bandwidth, disk space, and processing power, all of which are getting cheap fast.

Price performance of processing power is doubling about every 18 months (Moore's Law), price performance of disk space is doubling about every 12 months, and price performance of bandwidth is doubling about every 9 months. Given that last doubling rate, Amazon.com will be able to use 60 times as much bandwidth per customer 5 years from now while holding our bandwidth cost per customer constant. Similarly, price performance improvements in disk space and processing power will allow us to, for example, do ever more and better real-time personalization of our Web site.

In the physical world, retailers will continue to use technology to reduce costs, but not to transform the customer experience. We too will use technology to reduce costs, but the bigger effect will be using technology to drive adoption and revenue. We still believe that some 15% of retail commerce may ultimately move online.

While there are no foregone conclusions, and we still have much to prove, Amazon.com today is a unique asset. We have the brand, the customer relationships, the technology, the fulfillment infrastructure, the financial strength, the people, and the determination to extend our leadership in this infant industry and to build an important and lasting company. And we will do so by keeping the customer first.

The year 2001 will be an important one in our development. Like 2000, this year will be a year of focus and execution. As a first step, we've set the goal of achieving a pro forma operating profit in the fourth quarter. While we have a tremendous amount of work to do and there can be no guarantees, we have a plan to get there, it's our top priority, and every person in this company is committed to helping with that goal. I look forward to reporting to you our progress in the coming year.

As I usually do, I've appended our 1997 letter, our first letter to shareholders. It gets more interesting every year that goes by, in part because so little has changed. I especially draw your attention to the section entitled ''It's All About the Long Term.''

We at Amazon.com remain grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement. Many, many thanks.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

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1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

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Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

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Jeff P. Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

2001

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ANNUAL REPORT

To our shareholders:

In July of last year, Amazon.com reached an important way station. After four years of single-minded focus on growth, and then just under two years spent almost exclusively on lowering costs, we reached a point where we could afford to balance growth and cost improvement, dedicating resources and staffed projects to both. Our major price reduction in July, moving to discount books over $20 by 30% off list, marked this change.

This balance began to pay off in the fourth quarter, when we both significantly exceeded our own goals on the bottom line and simultaneously reaccelerated growth in our business. We lowered prices again in January when we offered a new class of shipping that is free (year-round) on orders over $99. Focus on cost improvement makes it possible for us to afford to lower prices, which drives growth. Growth spreads fixed costs across more sales, reducing cost per unit, which makes possible more price reductions. Customers like this, and it’s good for shareholders. Please expect us to repeat this loop.

As I mentioned, we exceeded our goals for the fourth quarter with pro forma operating profit of $59 million and pro forma net profit of $35 million. Thousands of Amazon.com employees around the world worked hard to achieve that goal; they are, and should be, proud of the accomplishment. More highlights from a notable year:

- Sales grew 13% from $2.76 billion in 2000 to $3.12 billion in 2001, and we achieved our first billion-dollar quarter on reaccelerated sales in Q4.
- We served 25 million customer accounts in 2001, compared to 20 million in 2000 and 14 million in 1999.
- International sales grew 74% in 2001, and more than one-quarter of sales came from outside the U.S. The U.K. and Germany, our largest international markets, had a combined pro forma operating profit for the first time in Q4. Open only a year, Japan grew to a $100 million annual run rate in Q4.
- Hundreds of thousands of small businesses and individuals made money by selling new and used products to our customers directly from our highly trafficked product detail pages. These Marketplace orders grew to 15% of U.S. orders in Q4, far surpassing our expectations when we launched Marketplace in November 2000.
- Inventory turns increased from 12 in 2000 to 16 in 2001.
- Most important, we stayed relentlessly focused on the customer, as reflected in a chart-topping score of 84 for the second year in a row on the widely followed American Customer Satisfaction Index conducted by the University of Michigan. We are told this is the highest score ever recorded--not just for any retailer, but for any service company.

Obsess over customers: our commitment continues

Until July, Amazon.com had been primarily built on two pillars of customer experience: selection and convenience. In July, as I already discussed, we added a third customer experience pillar: relentlessly lowering prices. You should know that our commitment to the first two pillars remains as strong as ever.

We now have more than 45,000 items in our electronics store (about seven times the selection you’re likely to find in a big-box electronics store), we’ve tripled our kitchen selection (you’ll find all the best brands), we’ve launched computer and magazine subscriptions stores, and we’ve added selection with strategic partners such as Target and Circuit City.

We’ve improved convenience with features like Instant Order Update which warns you if you’re about to buy the same item twice (people are busy--they forget that they’ve already bought it!).

We've dramatically improved customer self-service capabilities. Customers can now easily find, cancel, or modify their own orders. To find an order, just make sure you are signed in and recognized by the site, and do a regular search on any product in your order. When you get to that product's detail page, a link to your order will be at the top of the page.

We built a new feature called Look Inside the Book. Customers can view large high-resolution images of not only the front cover of a book, but also the back cover, index, table of contents, and a reasonable sample of the inside pages. They can Look Inside the Book before making a buying decision. It's available on over 200,000 of our millions of titles (as a point of comparison, a typical book superstore carries about 100,000 titles).

As my last example, I'll just point out that one of the most important things we've done to improve convenience and experience for customers also happens to be a huge driver of variable cost productivity: eliminating mistakes and errors at their root. Every year that's gone by since Amazon.com's founding, we've done a better and better job of eliminating errors, and this past year was our best ever. Eliminating the root causes of errors saves us money and saves customers time.

Our consumer franchise is our most valuable asset, and we will nourish it with innovation and hard work.

An investment framework

In every annual letter (including this one), we attach a copy of our original 1997 letter to shareholders to help investors decide if Amazon.com is the right kind of investment for them, and to help us determine if we have remained true to our original goals and values. I think we have.

In that 1997 letter, we wrote, "When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows."

Why focus on cash flows? Because a share of stock is a share of a company's future cash flows, and, as a result, cash flows more than any other single variable seem to do the best job of explaining a company's stock price over the long term.

If you could know for certain just two things--a company's future cash flows and its future number of shares outstanding--you would have an excellent idea of the fair value of a share of that company's stock today. (You'd also need to know appropriate discount rates, but if you knew the future cash flows *for certain*, it would also be reasonably easy to know which discount rates to use.) It's not easy, but you can make an informed forecast of future cash flows by examining a company's performance in the past and by looking at factors such as the leverage points and scalability in that company's model. Estimating the number of shares outstanding in the future requires you to forecast items such as option grants to employees or other potential capital transactions. Ultimately, your determination of cash flow per share will be a strong indicator of the price you might be willing to pay for a share of ownership in any company.

Since we expect to keep our fixed costs largely fixed, even at significantly higher unit volumes, we believe Amazon.com is poised over the coming years to generate meaningful, sustained, free cash flow. Our goal for 2002 reflects just that. As we said in January when we reported our fourth quarter results, we plan this year to generate positive operating cash flow, leading to free cash flow (the difference between the two is up to $75 million of planned capital expenditures). Our trailing twelve-month pro forma net income should, roughly but not perfectly, trend like trailing twelve-month cash flow.

Limiting share count means more cash flow per share and more long-term value for owners. Our current objective is to target net dilution from employee stock options (grants net of cancellations) to an average of 3% per year over the next five years, although in any given year it might be higher or lower.

Relentless commitment to long-term shareholder value

As I've discussed many times before, we are firm believers that the long-term interests of shareholders are tightly linked to the interests of our customers: if we do our jobs right, today's customers will buy more tomorrow, we'll add more customers in the process, and it will all add up to more cash flow and more long-term value for our shareholders. To that end, we are committed to extending our leadership in e-commerce in a way that benefits customers and therefore, inherently, investors--you can't do one without the other.

As we kick off 2002, I am happy to report that I am as enthusiastic as ever about this business. There is more innovation ahead of us than behind us, we are close to demonstrating the operating leverage of our business model, and I get to work with this amazing team of Amazonians all over the world. I am lucky and grateful. We thank you, our owners, for your support, your encouragement, and for joining us on this adventure. If you're a customer, we thank you again!

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

amazon.com

1997 LETTER TO SHAREHOLDERS
(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the long term. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.
- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million—an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000—a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.

- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2001

or

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

For the transition period from ______________ to ______________.

Commission File No. 000-22513

AMAZON.COM, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1646860**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

P.O. Box 81226
Seattle, Washington 98108-1226
(206) 266-1000
(Address, and telephone number, including area code, of registrant's principal executive offices)

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

None

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

Common Stock, par value $.01 per share

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes ☒ No ☐

Aggregate market value of voting stock held by non-affiliates of the registrant as of January 10, 2002	$2,859,000,000
Number of shares of common stock outstanding as of January 10, 2002	373,291,188

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of stockholders to be held in 2002, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

AMAZON.COM, INC.

FORM 10-K
For the Fiscal Year Ended December 31, 2001

INDEX

PART I

Item 1. *Business*

This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements based on expectations, estimates and projections as of the date of this filing. Actual results may differ materially from those expressed in forward-looking statements. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Forward-Looking Statements."

General

Amazon.com, Inc. commenced operations on the World Wide Web in July 1995 and seeks to offer Earth's Biggest Selection. We seek to be the world's most customer-centric company, where customers can find and discover anything they may want to buy online. We and our sellers list millions of unique items in categories such as books, music, DVDs, videos, electronics, computers, camera and photo items, software, computer and video games, cell phones and service, tools and hardware, outdoor living items, kitchen and houseware products, toys, baby and baby registry, travel services and magazine subscriptions. Through our Amazon Marketplace, Auctions and zShops services, businesses and individuals can sell virtually any product to our millions of customers, and with Amazon.com Payments, sellers are able to accept credit card transactions in addition to other methods of payment. We operate a U.S.-based Web site, *www.amazon.com*, and four internationally-focused Web sites: *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr* and *www.amazon.co.jp*.

Amazon.com was incorporated in 1994 in the state of Washington and reincorporated in 1996 in the state of Delaware. Our principal corporate offices are located in Seattle, Washington. We completed our initial public offering in May 1997, and our common stock is listed on the Nasdaq National Market under the symbol "AMZN."

As used herein, "Amazon.com," "we," "our" and similar terms include Amazon.com, Inc. and its subsidiaries, unless the context indicates otherwise.

Business Strategy

We seek to offer Earth's Biggest Selection and to be Earth's most customer-centric company, where customers can find and discover anything they may want to buy online. To accomplish our objective, we have developed three sales channels: online retail, marketplace and other, and third-party sellers. Revenue from each sales channel is recorded in one of our four operating segments: U.S. Books, Music and DVD/Video; U.S. Electronics, Tools and Kitchen; Services; and International. Historically, we have focused our sales efforts towards the individual consumer. In 2001, in addition to focusing on the individual consumer, we introduced our corporate and institutional buying program, which allows qualified businesses, libraries, schools, government institutions and other organizations to purchase products and services from our Web site using purchase orders in addition to credit cards or advance payments.

Online Retail. Our online retail stores offer a broad range of categories of new products to our customers. These products include books, music, DVDs, videos, electronics, computers, camera and photo items, software, computer and video games, cell phones and service, tools and hardware, outdoor living items, kitchen and houseware products, and magazine subscriptions. For most new products owned by us and offered on our online retail stores, whether U.S. or international, we purchase the products from vendors and hold them in our fulfillment centers to fulfill orders ourselves; in some cases, we have our vendors fulfill orders on our behalf. We anticipate continuing to expand the range of new online retail stores in the future.

Marketplace and Other. Marketplace and Other consists of Amazon Marketplace, Auctions and zShops, as well as certain of our non-retail Web sites. Marketplace, Auctions and zShops enhance the selection on our Web sites by offering new products, or used versions of new products we offer in our online retail stores, or offering additional products or services that expand or supplement our retail product offering. Amazon Marketplace permits sellers to utilize our e-commerce seller services and tools to present their product alongside our new product on the same product detail page on our Web site; a single Web page provides the customer a choice between purchasing a new product from us or the new or used product from the Amazon Marketplace seller. Amazon Auctions allows buyers and sellers to conduct transactions in an easy-to-use auction format. zShops allows individuals and businesses to create individual stores to offer popular as well as hard-to-find items to our customers. We also own the Internet Movie Database (*www.imdb.com*), a comprehensive and authoritative source of information on movie and entertainment titles, and cast and crew members.

Third-Party Sellers. The third-party sellers channel allows us to provide other companies a set of e-commerce services and tools for the sale of their goods and services. We have third-party seller arrangements with Toysrus.com, Inc., Target Corporation, Circuit City Stores, Inc., the Borders Group, Waterstones, Expedia, Inc., Hotwire, National Leisure Group, Inc., Virgin Wines, and others. We offer:

- Strong global brand recognition;
- Web merchandising, including our patented search technologies, personalization, 1-Click ordering, editorial content and customer reviews, and data-driven automation;
- Technology infrastructure;
- Customer service, including a global 24-hour customer support network, customer self-service technology, and proprietary e-commerce call center technology;
- Global fulfillment capabilities fully integrated to a Web site; and
- Customer traffic and acquisition involving our millions of customers and our Associates Program.

In 2001, we began marketing three services for third-party sellers that are designed to provide catalog retailers, physical store retailers and manufacturers with cost-effective e-commerce solutions and to expand the selection on our Web sites for the benefit of our customers:

- Merchant@amazon.com Program: The third party seller offers its products for sale on our Web site, either in our online retail stores or in a co-branded store on our Web site, or both. Its products are fully integrated on our Web site and are purchased by customers through a single checkout process. The third-party seller is the seller of record and pays us fixed fees, sales commissions, per-unit activity fees, or some combination thereof. In this program, we offer the option of providing fulfillment-related services on behalf of the third-party. Examples include the Toysrus.com toy store and Babiesrus.com baby store at *www.amazon.com*; the Target store at *www.amazon.com*, which is part of our strategic alliance with Target; our strategic alliance with Circuit City; and our strategic alliances that support our travel stores on our U.S. and U.K.-focused Web sites.
- Merchant Program: The third-party seller's e-commerce Web site operates at its own URL using our features and technology. In this program, we offer the option of providing fulfillment-related services on behalf of the third-party. We believe this offering will enable third-party sellers to have a high quality e-commerce site at a controllable and competitive cost. The third-party seller is the seller of record and pays us fixed fees, sales commissions, per-unit activity fees, or some combination thereof. An example is our features and technology that will be deployed at Target.com, which is scheduled to re-launch in the second half of 2002.
- Syndicated Stores Program: The third-party seller's e-commerce Web site uses our e-commerce services and tools, and offers our product selection. Under these arrangements, we are responsible for fulfillment and we provide customer service. We are the seller of record on these transactions and remit a commission to the third party. Examples include *www.borders.com* and *www.waterstones.co.uk*, both of which were launched in 2001 as Syndicated Stores.

Operating Segments

Commencing in January 2001, we organized our operations into four principal segments: U.S. Books, Music and DVD/Video; U.S. Electronics, Tools and Kitchen; Services; and International. See Note 16 of "Notes to Consolidated Financial Statements" included in Item 8 of Part II of this Form 10-K for additional information regarding our segments.

U.S. Books, Music and DVD/Video Segment. This segment includes retail sales from *www.amazon.com* of books, music and DVDs/video products and for magazine subscriptions. This segment also includes commissions from sales of these products, new or used, through Amazon Marketplace and product revenues from stores offering these products through our Syndicated Stores Program, such as *www.borders.com*.

The U.S. Books, Music and DVD/video segment had net sales of $1.69 billion, $1.70 billion, and $1.31 billion in 2001, 2000, and 1999, respectively. In 2001, we added the "Look Inside the Book" feature, which allows customers to view selected interior pages of thousands of books on our Web site. In addition, we launched our magazine store, where customers can subscribe to more than 600 magazine titles, and our e-documents store, where customers can purchase and download electronic documents.

U.S. Electronics, Tools and Kitchen Segment. This segment includes *www.amazon.com* retail sales of electronics, computers, camera and photo items, software, computer and video games, cell phones and service, tools and hardware, outdoor living items, kitchen and houseware products, toys and video games sold other than through our strategic alliance with Toysrus.com, Inc., as well as catalog sales of toys, tools and hardware. This segment also includes commissions from sales of these products, new or used, through Amazon Marketplace and commissions or other amounts earned from offerings of these products by third-party sellers through our Merchant@amazon.com Program, such as our strategic alliance with Circuit City.

The U.S. Electronics, Tools and Kitchen segment had net sales of $547 million, $484 million, and $151 million in 2001, 2000 and 1999, respectively. During 2001, we launched our computer store, and began our offering of in-store pick-up through our strategic alliance with Circuit City.

Services Segment. This segment consists of commissions, fees and other amounts earned from our business-to-business strategic alliances, including our Merchant Program and, to the extent product categories are not also offered by us through our online retail stores, our Merchant@amazon.com Program, as well as our strategic alliance with America Online, Inc. This segment also includes Auctions, zShops and Payments, and miscellaneous marketing and promotional agreements. Marketing responsibilities associated with successfully promoting the expansion of our third-party seller and other service offerings are placed with our management team leading this segment.

The Services segment had net sales of $225 million, $198 million, and $13 million in 2001, 2000 and 1999, respectively. In 2001, we entered into numerous strategic alliances with such companies as America Online and Target in the U.S., and Virgin Wines in the U.K. We also expanded our product offering under our Toysrus.com strategic alliance to include Babiesrus.com and Imaginarium.com co-branded stores at *www.amazon.com*. In addition, we entered into strategic alliances with Expedia, Hotwire and National Leisure Group to create our travel store.

International Segment. This segment includes all retail sales of our four internationally-focused Web sites: *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr* and *www.amazon.co.jp*. These international sites share a common Amazon experience, but are localized in terms of language, products, customer service and fulfillment. This segment includes commissions and other amounts earned from offerings of these products by third party sellers through our Merchant@amazon.com Program, and product revenues from stores offering products through our internationally-focused Syndicated Stores Program, such as *www.waterstones.co.uk*.

Net sales for the International segment (from all internationally-focused sites, including export sales to the U.S.) were $661 million, $381 million, and $168 million in 2001, 2000, and 1999, respectively. In 2001, *www.amazon.co.uk* and *www.amazon.de* each launched electronics stores, *www.amazon.fr* launched software and electronic games stores, and *www.amazon.co.jp* launched music, video, DVD, software and electronic games stores. In addition, *www.amazon.co.jp* introduced a new payment method to allow customers to pay with cash upon delivery of their order.

Amazon.com Web Sites

Our Web sites promote brand loyalty and repeat purchases by providing feature-rich content, a secure and trusted transaction environment, and easy-to-use functionality. The key features of our Web sites include broad selection, low prices, availability, convenience, information (including useful product information and reviews and personalized recommendations and notifications), discovery, 1-Click technology, secure payment systems, availability, fulfillment, browsing and searching. Other key features include Web pages tailored to individual customers' preferences, and, with our new "Look Inside the Book" feature, the ability to view selected interior pages of thousands of books. Our Wish List feature allows users to create an online wish list of desired products and services that others can reference for gift-giving purposes, and our Listmania feature allows users to publish lists with accompanying commentary regarding their favorite products on our Web site.

Marketing and Promotion

Our marketing strategy is designed to strengthen and broaden the Amazon brand name, increase customer traffic to our Web sites, build customer loyalty, encourage repeat purchases and develop incremental product and service revenue opportunities. We deliver personalized pages and services and employ a variety of media, business development activities and promotional methods to achieve these goals. We also benefit from public relations activities as well as online and traditional advertising, including radio, television and print media, and direct marketing.

We direct customers to our Web site through our Associates Program, which enables associated Web sites to make products available to their audiences with fulfillment performed by us. Currently, over 700,000 Web sites have enrolled in the Associates Program.

Customer Service

We believe that our ability to establish and maintain long-term relationships with our customers and to encourage repeat visits and purchases depends, in part, on the strength of our customer service operations, and we continually seek to improve the Amazon customer service experience. Users can contact customer service representatives 24 hours a day, seven days a week. We have automated certain tools used by our customer service staff and have plans for further enhancements. We currently have customer service personnel working in six customer service centers located in Tacoma, Washington; Slough, England; Regensburg, Germany; Grand Forks, North Dakota; Huntington, West Virginia; and Sapporo, Japan. In addition, we have customer-service outsourcing arrangements with vendors in India, Northern Ireland, and the U.S., respectively.

Warehousing, Inventory, Fulfillment and Distribution

We currently lease and operate U.S. fulfillment facilities in New Castle, Delaware; Coffeyville, Kansas; Campbellsville and Lexington, Kentucky; Fernley, Nevada; and Grand Forks, North Dakota; as well as a seasonal fulfillment center, used as necessary, in Seattle, Washington. We also lease and operate three European fulfillment centers that are located in the United Kingdom, France and Germany. In Japan, Nippon Express, a leading courier company, provides fulfillment services for orders from *www.amazon.co.jp*. On an aggregate basis, these fulfillment centers comprise approximately 4.0 million square feet of warehouse space. In addition, we lease four off-site facilities that fluctuate from 340,000 to 710,000 square feet of space, which support the storage and fulfillment functions of the U.S. fulfillment centers. Our fulfillment centers facilitate our ability to deliver our merchandise, as well as third-party seller merchandise, to customers on a reliable and timely basis.

Seasonality

Our business is generally affected by both seasonal fluctuations in Internet usage (which generally declines during summer months) and traditional retail seasonality. Traditional retail sales for most of our products, including books, music, DVDs, videos, toys and electronics usually increase significantly in the fourth calendar quarter of each year. In particular, the fourth quarter seasonal effect may be even more pronounced in our sales of toys, which are mainly sold through our strategic alliance with Toysrus.com, and in our sales of electronics, in comparison with our other product categories.

Technology

We have implemented numerous Web-site management, search, customer interaction, recommendation, transaction-processing and fulfillment services and systems using a combination of our own proprietary technologies and commercially available, licensed technologies. Our current strategy is to focus our development efforts on creating and enhancing the specialized, proprietary software that is unique to our business and to license or acquire commercially-developed technology for other applications where available and appropriate.

We use a set of applications for accepting and validating customer orders, placing and tracking orders with suppliers, managing and assigning inventory to customer orders and ensuring proper shipment of products to customers based on various ordering criteria. Our transaction-processing systems handle millions of items, a number of different status inquiries, gift-wrapping requests and multiple shipment methods, and allow the customer to choose whether to receive single or several shipments based on availability and to track the progress of each order. These applications also manage the process of accepting, authorizing and charging customer credit cards. Our Web sites also incorporate a variety of search and database tools and provide personalized features for individual customers such as instant personalized recommendations, personalized notifications and wish lists.

Competition

The online-commerce retail channel is relatively new, rapidly evolving and intensely competitive. In addition, the retail environment for our products is generally intensely competitive. Our current or potential competitors include: (1) physical-world retailers, catalog retailers, publishers, distributors and manufacturers of our products, many of which possess significant brand awareness, sales volume and customer bases, and some of which currently sell, or may sell, products or services through the Internet, mail order or direct marketing; (2) online vendors of products that we sell; (3) a number of indirect competitors, including Web portals and Web search engines that are involved in online commerce, either directly or in collaboration with other retailers; (4) Web-based retailers using alternative-fulfillment capabilities; and (5) companies that provide e-commerce services, including Web-site developers and third-party fulfillment and customer-service providers. We believe that the principal competitive factors in our market segments include selection, price, availability, convenience, information, discovery, brand recognition, personalized services, accessibility, customer service, reliability, speed of fulfillment, ease of use and ability to adapt to changing conditions. For our services segment and third-party sellers channel, additional competitive factors include the quality of our services and tools, and speed of performance for our services. As the online-commerce market segments continue to grow, other companies may also enter into business combinations or alliances that strengthen their competitive positions.

Intellectual Property

We regard our trademarks, service marks, copyrights, patents, trade dress, trade secrets, proprietary technology and similar intellectual property as critical to our success, and we rely on trademark, copyright and patent law, trade-secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. We have been issued a number of trademarks, service marks, patents and copyrights by U.S. and foreign governmental authorities. We also have applied for the registration of other trademarks, service marks and copyrights in the U.S. and internationally, and we have filed U.S. and international patent applications covering certain of our proprietary technology. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights, such as trademarks, patents, technologies or copyrighted materials, to third parties.

Employees

As of December 31, 2001, we employed approximately 7,800 full-time and part-time employees. We also employ independent contractors and temporary personnel on a seasonal basis. None of our employees are represented by a labor union and we consider our employee relations to be good. Competition for qualified personnel in our industry is intense, particularly for software-development and other technical staff. We believe that our future success will depend in part on our continued ability to attract, hire and retain qualified personnel.

Additional Factors That May Affect Future Results

The following risk factors and other information included in this Annual Report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

We Have an Accumulated Deficit and May Incur Additional Losses

We have incurred significant losses since we began doing business. As of December 31, 2001, we had an accumulated deficit of $2.86 billion and our stockholders' equity was a deficit of $1.44 billion. We have incurred substantial operating losses since our inception and, notwithstanding our recent performance in the fourth quarter of 2001, we may continue to incur such losses for the foreseeable future.

We Have Significant Indebtedness

As of December 31, 2001, we had total long-term indebtedness under our 10% Senior Discount Notes due 2008 (the "Senior Discount Notes"), convertible notes, capitalized-lease obligations and other asset financings of $2.16 billion. We make annual or semi-annual interest payments on the indebtedness under our two tranches of convertible notes, which are due in 2009 and 2010, respectively. Beginning in November 2003, we will begin to make semi-annual interest payments on the indebtedness under our Senior Discount Notes. We may incur substantial additional debt in the future. Our indebtedness could limit our ability to obtain necessary additional financing for working capital, capital expenditures, debt service requirements or other purposes in the future; plan for, or react to, changes in technology and in our business and competition; and react in the event of an economic downturn.

We may not be able to meet our debt service obligations. If we are unable to generate sufficient cash flow or obtain funds for required payments, or if we fail to comply with covenants in our indebtedness, we will be in default.

We Face Intense Competition

The e-commerce market segments in which we compete are relatively new, rapidly evolving and intensely competitive. In addition, the market segments in which we participate are intensely competitive and we have many competitors in different industries, including the Internet and retail industries.

Many of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we have. They may be able to secure merchandise from vendors on more favorable terms and may be able to adopt more aggressive pricing policies. Competitors in both the retail and e-commerce services industries also may be able to devote more resources to technology development and marketing than us.

Other companies in the retail and e-commerce service industries may enter into business combinations or alliances that strengthen their competitive positions. We also expect that competition in the e-commerce channel will intensify. As various Internet market segments obtain large, loyal customer bases, participants in those segments may expand into the market segments in which we operate. In addition, new and expanded Web technologies may further intensify the competitive nature of online retail. The nature of the Internet as an electronic marketplace facilitates competitive entry and comparison shopping and renders it inherently more competitive than conventional retailing formats. This increased competition may reduce our sales and/or operating profits.

Our Business Could Suffer if We Are Unsuccessful in Making and Integrating Strategic Alliances

We may enter into strategic alliances with other companies through commercial agreements, joint ventures, investments or business combinations. We have entered into third-party services agreements to provide services related to e-commerce to companies like Toysrus.com, Borders Group, America Online, Circuit City Stores, and Target, and we plan to enter into similar agreements in the future. Under such agreements, we may perform services such as offering consumer products sold by us through Syndicated Stores; allowing third parties to utilize our technology services such as search, browse and personalization; permitting third parties to offer products or services through our Web site; and powering third-party Web sites, providing fulfillment services, or both. These arrangements are complex and initially require substantial personnel and resource commitments by us, which may constrain the number of such agreements we are able to enter into and may affect our ability to deliver services under the relevant agreements. If we fail to implement, maintain and develop successfully the various components of such arrangements, which may include fulfillment, customer service, inventory management, tax collection, and third party licensing of software, hardware and content, our strategic alliance initiatives may not be viable. The amount of compensation we receive under certain of these agreements is dependent on the volume of sales that the other company makes. Therefore if the third party Web site or product or services offering is not successful, we may not receive all of the compensation we are otherwise due under the terms of the agreement. Moreover, we may not be able to succeed in our plans to enter into additional strategic alliances on favorable terms.

In addition, our present and future third-party services agreements, other commercial agreements, joint ventures, investments and business combinations create risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- impairment of relationships with existing employees, customers and companies with which we have formed strategic alliances;
- difficulty assimilating the operations, technology and personnel of combined companies;
- problems retaining key technical and managerial personnel;
- additional operating losses and expenses of acquired businesses; and
- fluctuations in value and losses that may arise from our equity investments.

The Seasonality of Our Business Places Increased Strain on Our Business

We expect a disproportionate amount of our net sales to be realized during the fourth quarter of our fiscal year. If we do not stock popular products in sufficient amounts and fail to meet customer demand, it could significantly affect our revenue and our future growth. If we overstock products, we may be required to take significant inventory markdowns or write-offs, which could reduce gross profits. A failure to optimize inventory in our fulfillment network will harm our shipping margins by requiring us to make partial shipments from one or more locations. In addition, we may experience a decline in our shipping margins due to complimentary upgrades, split-shipments and additional long-zone shipments necessary to ensure timely delivery especially for the holiday season. If too many customers access our Web sites within a short period of time due to increased holiday or other demand, we may experience system interruptions that make our Web sites unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. In addition, we may be unable to adequately staff our fulfillment centers during these peak periods, and we, along with our customer service outsourcers, may be unable to adequately staff customer service centers.

We generally have payment terms with our vendors that extend beyond the amount of time necessary to collect proceeds from our customers. As a result of holiday sales, at December 31 of each year our cash, cash equivalents and marketable securities balance reaches its highest level (other than as a result of cash flows provided by investing and financing activities). This operating cycle results in a corresponding increase in accounts payable. Our accounts payable balance will decline during the first three months following year-end and will result in a decline in the amount of cash, cash equivalents and marketable securities on hand.

We May Experience Significant Fluctuations in Our Operating Results and Rate of Growth

Due to our limited operating history, our evolving business model and the unpredictability of our industry, we may not be able to accurately forecast our rate of growth. We base our current and future expense levels and our investment plans on estimates of future net sales and rate of growth. Our expenses and investments are to a large extent fixed. We may not be able to adjust our spending quickly if our net sales fall short of our expectations.

Our revenue and operating profit growth depends on the continued growth of online demand for the products offered by us or our third party sellers, and our business is affected by general economic and business conditions throughout the world. A softening of demand, whether caused by changes in consumer preferences or a weakening of the U.S. or global economies, may result in decreased revenue or growth. Recent terrorist attacks upon the U.S. have added economic and consumer uncertainty that could adversely affect our revenue or growth. Security concerns could create delays in and increase the cost of product shipments to and from us, which may decrease demand. Revenue growth may not be sustainable and our company-wide percentage growth rate may decrease in the future.

Our net sales and operating results will also fluctuate for many other reasons, including:

- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' demands;
- our ability to expand our network of third party sellers;
- foreign currency exchange rate fluctuations;
- our ability to acquire merchandise, manage our inventory and fulfill orders;
- the introduction by our competitors of Web sites, products or services;
- changes in usage of the Internet and online services and consumer acceptance of the Internet and e-commerce;
- timing and costs of upgrades and developments in our systems and infrastructure;
- the effects of strategic alliances, acquisitions and other business combinations, and our ability to successfully integrate them into our business;
- technical difficulties, system downtime or Internet brownouts;
- variations in the mix of products and services we sell;
- variations in our level of merchandise and vendor returns;
- disruptions in service by shipping carriers; and

- the extent to which we offer free shipping promotions.

Finally, both seasonal fluctuations in Internet usage and traditional retail seasonality are likely to affect our business. Internet usage generally slows during the summer months, and sales in almost all of our product groups, particularly toys and electronics, usually increase significantly in the fourth calendar quarter of each year.

We Have Foreign Currency Exchange Rate Risk

We may be adversely affected by foreign currency exchange rate risk. Our 6.875% Convertible Subordinated Notes due 2010 ("6.875% PEACS") are denominated in Euros, not U.S. dollars, and the exchange ratio between the Euro and the U.S. dollar is not fixed by the indenture governing the 6.875% PEACS. When we periodically remeasure the principal of the 6.875% PEACS fluctuations in the Euro/U.S. dollar exchange ratio, we will record non-cash gains or losses in "Other gains (losses), net" on our statements of operations. Furthermore, we have invested some of the proceeds from the 6.875% PEACS in Euro-denominated cash equivalents and marketable securities. Accordingly, as the U.S. dollar strengthens compared to the Euro, cash equivalents and marketable securities balances, when translated, may be materially less than expected and vice versa.

In addition, the results of operations of our internationally-focused Web sites are exposed to foreign currency exchange rate fluctuations as the financial results of the applicable subsidiaries are translated from the local currency into U.S. dollars upon consolidation. As exchange rates vary, net sales and other operating results, when translated, may differ materially from expectations.

Our Past and Planned Future Growth Will Place a Significant Strain on our Management, Operational and Financial Resources

We have rapidly and significantly expanded our operations and will endeavor to expand further to pursue growth of our product and service offerings and customer base. Such growth will continue to place a significant strain on our management, operational and financial resources. We also need to train and manage our employee base. Our current and planned personnel, systems, procedures and controls may not be adequate to support and effectively manage our future operations. We may not be able to hire, train, retain, motivate and manage required personnel, which may limit our growth.

In addition, we do not expect to benefit in our newer market segments from the first-to-market advantage that we experienced in the online book channel. Our gross profits in our newer business activities may be lower than in our older business activities. In addition, we may have limited or no experience in new product and service activities and our customers may not favorably receive our new businesses. In addition, to the extent we pursue strategic alliances to facilitate new product or service activities, the alliances may not be successful. If any of this were to occur, it could damage our reputation and negatively affect revenue growth.

The Loss of Key Senior Management Personnel Could Negatively Affect Our Business

We depend on the continued services and performance of our senior management and other key personnel, particularly Jeffrey P. Bezos, our President, Chief Executive Officer and Chairman of the Board. We do not have "key person" life insurance policies. The loss of any of our executive officers or other key employees could harm our business.

System Interruption and the Lack of Integration and Redundancy in Our Systems May Affect Our Sales

Customer access to our Web sites directly affects the volume of goods we sell and thus affects our net sales. We experience occasional system interruptions that make our Web sites unavailable or prevent us from efficiently fulfilling orders, which may reduce our net sales and the attractiveness of our products and services. To prevent system interruptions, we continually need to add additional software and hardware, upgrade our systems and network infrastructure to accommodate both increased traffic on our Web sites and increased sales volume, and integrate our systems.

Our computer and communications systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, break-ins, earthquakes, acts of war or terrorism and similar events. We do not have backup systems or a formal disaster recovery plan, and we may have inadequate insurance coverage or insurance limits to compensate us for losses from a major interruption. Computer viruses, physical or electronic break-ins and similar disruptions could cause system interruptions, delays and loss of critical data, and could prevent us from providing services and accepting and fulfilling customer orders. If this were to occur, it could damage our reputation and be expensive to remedy.

We May Not Be Successful in Our Efforts to Expand into International Market Segments

We plan, over time, to continue to expand our reach in international market segments. We have relatively little experience in purchasing, marketing and distributing products or services for these market segments and may not benefit from any first-to-market advantages. It is costly to establish international facilities and operations, promote our brand internationally, and develop localized Web sites and stores and other systems. We may not succeed in these efforts. Our net sales from international market segments may not offset the expense of establishing and maintaining the related operations and, therefore, these operations may never be profitable.

Our international sales and related operations are subject to a number of risks inherent in selling abroad, including, but not limited to, risks with respect to:

- currency exchange rate fluctuations,
- local economic and political conditions,
- restrictive governmental actions (such as trade protection measures, including export duties and quotas and custom duties and tariffs),
- import or export licensing requirements,
- limitations on the repatriation of funds,
- difficulty in obtaining distribution and support,
- nationalization,
- longer receivable cycles,
- consumer protection laws and restrictions on pricing or discounts,
- lower level of adoption or use of the Internet and other technologies vital to our business, and the lack of appropriate infrastructure to support widespread Internet usage,
- lower level of credit card usage and increased payment risk,
- difficulty in developing employees and simultaneously managing a larger number of unique foreign operations as a result of distance, language and cultural differences,
- laws and policies of the U.S. affecting trade, foreign investment and loans, and
- tax and other laws.

As the international e-commerce channel continues to grow, competition will likely intensify. Local companies may have a substantial competitive advantage because of their greater understanding of, and focus on, the local customer, as well as their more established local brand name recognition. In addition, governments in foreign jurisdictions may regulate e-commerce or other online services in such areas as content, privacy, network security, copyright, encryption, taxation or distribution. We may not be able to hire, train, retain, motivate and manage required personnel, which may limit our growth in international market segments.

Our Strategic Alliances Subject Us to a Number of Risks

Beginning in 1999, we offered services to other e-commerce companies including permitting third parties to offer products or services on our Web site, and promotional services such as advertising placements and customer referrals. We may enter into similar transactions in the future. Beginning with our strategic alliance with Toysrus.com in 2000, we began expanding our range of services. We now offer a variety of services to third parties, including offering consumer products sold by us through Syndicated Stores; allowing third parties to utilize our technology services such as search, browse and personalization; and powering third-party Web-sites, providing fulfillment services, or both. In exchange for the services we provide under these agreements, we receive cash and/or equity securities of these companies (additional benefits may include Web site traffic). The amount of compensation we receive under certain of these agreements is dependent on the volume of sales made by the other company. In some cases, such as our agreement with drugstore.com, we have also made separate investments in the other company by making a cash payment in exchange for equity securities of that company. As part of this program, we may in the future make additional investments in companies with which we have already formed strategic alliances or companies with which we form new strategic alliances or similar arrangements. To the extent we have received equity securities as compensation, fluctuations in the value of such securities will affect our ultimate realization of amounts we have received as compensation for services.

We hold several investments in third parties, primarily investments in companies with which we have formed strategic alliances, that are accounted for using the equity method. Under the equity method, we are required to record our ownership percentage of the income or loss of these companies as income or loss for us. We record these amounts generally one month in arrears for private companies and three months in arrears for public companies. The losses we are required to record under the equity method with respect to a particular investment are limited to the carrying value of that investment. As of December 31, 2001, the carrying amount of several of our equity-method investees has been reduced to zero. The only remaining investees with carrying amounts are privately-held companies. The companies in which we have equity method investments are engaged in the Internet and e-commerce industries, are likely to experience large losses for the foreseeable future and may or may not be ultimately successful. Accordingly, we expect to record additional equity method losses in the future. Our investments in equity securities that are not accounted for under the equity method are included in "Marketable securities" and "Other equity investments" on our balance sheets.

We regularly review all of our investments in public and private companies for other-than-temporary declines in fair value. When we determine that the decline in fair value of an investment below our accounting basis is other-than-temporary, we reduce the carrying value of the securities we hold and record a loss in the amount of any such decline. During 2001, we determined that the declines in value of several of these investments were other-than-temporary, and we recognized losses totaling $44 million to record these investments at their then current fair value. Several of these companies have declared bankruptcy or liquidated.

We had net unrealized gains of $1 million on available-for-sale equity securities included in accumulated other comprehensive loss as of December 31, 2001, and have recorded equity-method losses of $30 million for the year ended December 31, 2001. In recent quarters, companies in the Internet and e-commerce industries have experienced significant difficulties, including difficulties in raising capital to fund expansion or to continue operations. We may conclude in future quarters that the fair values of other of these investments have experienced an other-than-temporary decline. As of December 31, 2001, our recorded basis in equity securities was $41 million, including $13 million classified as "Marketable securities," $10 million classified as "Investments in equity-method investees," and $18 million classified as "Other equity investments." In addition, if companies with which we have formed strategic alliances experience such difficulties, we may not receive or fully realize the consideration owed to us and the value of our investment may become worthless. As our strategic alliances and similar agreements expire or otherwise terminate, we may be unable to renew or replace these agreements on terms that are as favorable to us, or at all.

During 2000 and 2001, we amended several of our agreements with certain of the companies with which we have formed strategic alliances that reduced future cash proceeds to be received by us, shortened the term of our commercial agreements, or both. We may, in the future, enter into further amendments of our commercial agreements. Although these amendments did not affect the amount of unearned revenue previously recorded by us, the timing of revenue recognition of these recorded unearned amounts has been changed to correspond with the terms of the amended agreements. To the extent we believe any such amendments cause or may cause the compensation to be received under an agreement to no longer be fixed or determinable, we limit our revenue recognition to amounts received, excluding any future amounts not deemed fixed or determinable. As future amounts are subsequently received, such amounts are incorporated into our revenue recognition over the remaining term of the agreement.

We Face Significant Inventory Risk Arising Out of Changes in Consumer Demand and Product Cycles

We are exposed to significant inventory risks as a result of seasonality, new product launches, rapid changes in product cycles and changes in consumer tastes with respect to our products. In order to be successful, we must accurately predict these trends and avoid overstocking or under-stocking products. Demand for products, however, can change significantly between the time inventory is ordered and the date of sale. In addition, when we begin selling a new product, it is particularly difficult to forecast product demand accurately. A failure to optimize inventory within our fulfillment network will harm our shipping margins by requiring us to make split shipments from one or more locations, complimentary upgrades, and additional long-zone shipments necessary to ensure timely delivery. As a result of our agreements with Toysrus.com, Babiesrus.com, and Target, these parties will identify, buy, manage and bear the financial risk of inventory obsolescence for their corresponding stores and merchandise. As a result, if any of these parties fail to forecast product demand or optimize inventory, we would receive reduced service fees under the agreements and our business and reputation could be harmed.

The acquisition of certain types of inventory, or inventory from certain sources, may require significant lead-time and prepayment, and such inventory may not be returnable. We carry a broad selection and significant inventory levels of certain products, such as consumer electronics, and we may be unable to sell products in sufficient quantities or during the relevant selling seasons.

Our ability to receive inbound inventory efficiently or ship completed orders to customers may be negatively effected by inclement weather, fire, flood, power loss, earthquakes, acts of war or terrorism or acts of God.

Any one of the factors set forth above may require us to mark down or write off inventory, which will adversely affect our operating results.

If We Do Not Successfully Optimize and Operate Our Fulfillment Centers, Our Business Could Be Harmed

If we do not successfully operate our fulfillment centers, it could significantly limit our ability to meet customer demand. Most of our fulfillment centers are highly automated, and we have had limited experience with automated fulfillment centers. Because it is difficult to predict sales increases, we may not manage our facilities in an optimal way, which may result in excess inventory, warehousing, fulfillment and distribution capacity. In January 2001, we closed our fulfillment center in McDonough, Georgia and decided to operate the Seattle, Washington fulfillment center on a seasonal basis, if necessary. Under some of our strategic alliances, we maintain the inventory of other companies in our fulfillment centers, thereby increasing the complexity of tracking inventory in and operating our fulfillment centers. Our failure to properly handle such inventory would result in unexpected costs and other harm to our business and reputation.

We May Not Be Able to Adequately Protect Our Intellectual Property Rights or May Be Accused of Infringing Intellectual Property Rights of Third Parties

We regard our trademarks, service marks, copyrights, patents, trade dress, trade secrets, proprietary technology and similar intellectual property as critical to our success, and we rely on trademark, copyright and patent law, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our products and services are made available online. We also may not be able to acquire or maintain appropriate domain names in all countries in which we do business. Furthermore, regulations governing domain names may not protect our trademarks and similar proprietary rights. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or diminish the value of our trademarks and other proprietary rights. Policing unauthorized use of our proprietary rights is inherently difficult, and we may not be able to determine the existence or extent of any such unauthorized use. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, we cannot be certain that the steps we take to protect our intellectual property will adequately protect our rights or that others will not independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights.

Third parties that license our proprietary rights may take actions that diminish the value of our proprietary rights or reputation. In addition, the steps we take to protect our proprietary rights may not be adequate and third parties may infringe or misappropriate our copyrights, trademarks, trade dress, patents and similar proprietary rights. Other parties may claim that we infringed their proprietary rights. We have been subject to, and expect to continue to be subject to, claims and legal proceedings regarding alleged infringement by us of the patents, trademarks and other intellectual property rights of third parties. Such claims, whether or not meritorious, may result in the expenditure of significant financial and managerial resources, injunctions against us or the imposition of damages that we must pay. We may need to obtain licenses from third parties who allege that we have infringed their rights, but such licenses may not be available on terms acceptable to us, or at all. In addition, we may not be able to obtain or utilize on terms which are favorable to us, or at all, licenses or other rights with respect to intellectual property we do not own in providing e-commerce services to third party sellers or other companies under strategic alliance agreements.

We Have a Limited Operating History and Our Stock Price Is Highly Volatile

We have a relatively short operating history and, as an e-commerce company, we have a rapidly evolving and unpredictable business model. The trading price of our common stock fluctuates significantly. Trading prices of our common stock may fluctuate in response to a number of events and factors, such as:

- general economic conditions,
- changes in interest rates,
- conditions or trends in the Internet and the e-commerce industry,
- fluctuations in the stock market in general and market prices for Internet-related companies in particular,
- quarterly variations in operating results,
- new products, services, innovations and strategic developments by our competitors or us, or business combinations and investments by our competitors or us,
- changes in financial estimates by us or securities analysts and recommendations by securities analysts,
- changes in Internet regulation,
- changes in capital structure, including issuance of additional debt or equity to the public,
- additions or departures of key personnel,
- corporate restructurings, including layoffs or closures of facilities,
- changes in the valuation methodology of, or performance by, other e-commerce companies, and
- news and securities analyst reports and speculation relating to new alliances, general business or Internet trends or our existing or future products or services.

Any of these events may cause our stock price to rise or fall, and may adversely affect our business and financing opportunities.

Future volatility in our stock price could force us to increase our cash compensation to employees or grant larger stock option awards than we have historically, which could hurt our operating results, or reduce the percentage ownership of our existing stockholders, or both. In the first quarter of 2001, we offered a limited non-compulsory exchange of employee stock options. This option exchange offer results in variable accounting treatment for stock options representing, at December 31, 2001, approximately 12 million shares of our common stock. Variable accounting treatment will result in unpredictable stock-based compensation dependent on fluctuations in quoted prices for our common stock.

Government Regulation of the Internet and E-commerce Is Evolving and Unfavorable Changes Could Harm our Business

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet and e-commerce. Such existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations may cover taxation, user privacy, pricing, content, copyrights, distribution, electronic contracts, consumer protection, and characteristics and quality of products and services. It is not clear how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet and e-commerce. Unfavorable resolution of these issues may harm our business. In addition, many jurisdictions currently regulate "auctions" and "auctioneers" and may regulate online auction services. Jurisdictions may also regulate consumer-to-consumer fixed price online markets, like zShops. This could, in turn, diminish the demand for our products and services and increase our cost of doing business.

We May Be Subject to Liability for Past Sales and Our Future Sales May Decrease

In accordance with current industry practice, we do not collect sales taxes or other taxes with respect to shipments of most of our goods into states other than Washington and North Dakota. Under our agreements with Babiesrus.com, Target and Circuit City, the other company is the seller of record of the applicable merchandise and we are obligated to collect sales tax in most states in accordance with that company's instructions. We may enter into additional strategic alliances requiring similar tax collection obligations. We collect Value Added Tax, or VAT, for products that are ordered on *www.amazon.co.uk, www.amazon.de* and *www.amazon.fr* and that are shipped into European Union member countries. We also collect Japanese consumption tax for products that are ordered on *www.amazon.co.jp* and that are shipped into Japan. Our fulfillment center and customer service center networks, and any future expansion of those networks, along with other aspects of our evolving business, may result in additional sales and other tax obligations. One or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies which engage in e-commerce. A successful assertion by one or more states or foreign countries that we should collect sales or other taxes on the sale of merchandise could result in substantial tax liabilities for past sales, decrease our ability to compete with traditional retailers and otherwise harm our business.

Currently, decisions of the U.S. Supreme Court restrict the imposition of obligations to collect state and local sales and use taxes with respect to sales made over the Internet. However, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's position regarding sales and use taxes on Internet sales. If any of these initiatives addressed the Supreme Court's constitutional concerns and resulted in a reversal of its current position, we could be required to collect sales and use taxes in states other than Washington and North Dakota. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us and could decrease our future sales.

Various countries are currently evaluating their VAT positions on e-commerce transactions. Recently, for example, the Council of Economic and Finance Ministers of the European Union proposed a directive requiring that businesses in non-EU countries selling digital products and services to EU resident consumers collect and remit VAT in the country of the consumer's residence. If this directive is ratified by the EU Council of Ministers, it would likely become effective on January 1, 2003. It is possible that this and other future VAT legislation or changes to our business model may result in additional VAT collection obligations and administrative burdens.

We Source a Significant Portion of Our Inventory from a Few Vendors

Although we continue to increase our direct purchasing from manufacturers, we still source a significant amount of inventory from relatively few vendors. During 2001, approximately 21% of all inventory purchases were made from three major vendors, of which Ingram Book Group accounts for over 10%. We do not have long-term contracts or arrangements with most of our vendors to guarantee the availability of merchandise, particular payment terms or the extension of credit limits. Our current vendors may stop selling merchandise to us on acceptable terms. If that were the case, we may not be able to acquire merchandise from other suppliers in a timely and efficient manner and on acceptable terms.

We May Be Subject to Product Liability Claims if People or Property Are Harmed by the Products We Sell

Some of our products, such as toys, tools, hardware, computers, cell phones and kitchen and houseware products, may expose us to product liability claims relating to personal injury, death or property damage caused by such products, and may require us to take actions such as product recalls. Companies with which we have formed strategic alliances also may sell products that may indirectly increase our exposure to product liability claims. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all. In addition, some of our vendor agreements with our suppliers do not indemnify us from product liability.

We Could Be Liable for Breaches of Security on Our Web Site and Fraudulent Activities of Users of Our Amazon Payments Program

A fundamental requirement for e-commerce is the secure transmission of confidential information over public networks. Although we have developed systems and processes that are designed to prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may adversely affect our financial results.

The law relating to the liability of providers of online payment services is currently unsettled. We guarantee payments made through Amazon Payments up to certain limits for both buyers and sellers, and we may be unable to prevent users of Amazon Payments from fraudulently receiving goods when payment may not be made to a seller or fraudulently collecting payments when goods may not be shipped to a buyer. Our liability risk will increase as a larger fraction of our sellers use Amazon Payments. Any costs we incur as a result of liability because of our guarantee of payments made through Amazon Payments or otherwise could harm our business. In addition, the functionality of Amazon Payments depends on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, Amazon Payments will not be viable (and our businesses that use Amazon Payments may not be viable).

We May Not Be Able to Adapt Quickly Enough to Changing Customer Requirements and Industry Standards

Technology in the e-commerce industry changes rapidly. We may not be able to adapt quickly enough to changing customer requirements and preferences and industry standards. Competitors often introduce new products and services with new technologies. These changes and the emergence of new industry standards and practices could render our existing Web sites and proprietary technology obsolete.

The Internet as a Medium for Commerce Is Uncertain

Consumer use of the Internet as a medium for commerce is a recent phenomenon and is subject to a high level of uncertainty. While the number of Internet users has been rising, the Internet infrastructure may not expand fast enough to meet the increased levels of demand. If use of the Internet as a medium for commerce does not continue to grow or grows at a slower rate than we anticipate, our sales would be lower than expected and our business would be harmed.

We Could Be Liable for Unlawful or Fraudulent Activities by Users of Our Marketplace, Auctions and zShops Services

We may be unable to prevent users of our Amazon Marketplace, Auctions and zShops services from selling unlawful goods, or from selling goods in an unlawful manner. We may face civil or criminal liability for unlawful and fraudulent activities by our users under U.S. laws and/or the laws and regulations of other countries. Any costs we incur as a result of liability relating to the sale of unlawful goods, the unlawful sale of goods, the fraudulent receipt of goods or the fraudulent collection of payments could harm our business.

In running our Amazon Marketplace, Auctions and zShops services, we rely on sellers of goods to make accurate representations and provide reliable delivery, and on buyers to pay the agreed purchase price. We do not take responsibility for delivery of payment or goods and while we can suspend or terminate the accounts of users who fail to fulfill their delivery obligations to other users, we cannot require users to make payments or deliver goods. We do not compensate users who believe they have been defrauded by other users except through our guarantee program. Under the guarantee program, fraudulent activities by our users, such as the fraudulent receipt of goods and the fraudulent collection of payments, may create liability for us. In addition, we are aware that governmental agencies are currently investigating the conduct of online auctions and could require changes in the way we conduct this business.

Executive Officers and Directors

The following tables set forth certain information regarding our executive officers and Directors as of January 15, 2002:

Executive Officers

Name	Age	Position
Jeffrey P. Bezos	38	President, Chief Executive Officer and Chairman of the Board
Mark J. Britto	37	Senior Vice President, Worldwide Service Sales & Business Development
Richard L. Dalzell	44	Senior Vice President, Worldwide Architecture & Platform Software, and Chief Information Officer
Warren C. Jenson	45	Senior Vice President and Chief Financial Officer
Diego Piacentini	41	Senior Vice President, Worldwide Retail & Marketing
John D. Risher	36	Senior Vice President, Worldwide Application Software
Jeffrey A. Wilke	35	Senior Vice President, Worldwide Operations & Customer Service
L. Michelle Wilson	38	Senior Vice President, Human Resources, General Counsel and Secretary

Jeffrey P. Bezos. Mr. Bezos has been Chairman of the Board of Amazon.com since founding it in 1994 and Chief Executive Officer since May 1996. Mr. Bezos served as President from founding until June 1999 and again from October 2000 to the present. He served as Treasurer and Secretary from May 1996 to March 1997. From December 1990 to June 1994, Mr. Bezos was employed by D.E. Shaw & Co., a Wall Street investment firm, becoming Senior Vice President in 1992. From April 1988 to December 1990, Mr. Bezos was employed by

Bankers Trust Company, becoming Vice President in February 1990. Mr. Bezos received his B.S. in Electrical Engineering and Computer Science from Princeton University.

Mark J. Britto. Mr. Britto has served as Senior Vice President, Worldwide Service Sales and Business Development since November 2001. From February 2001 until November 2001, Mr. Britto was Senior Vice President, Cross-Site Merchandising. He served as Senior Vice President, Marketing and Cross-Site Merchandising from October 2000 until February 2001 and as Vice President, Strategic Alliances from August 1999 to October 2000. From June 1999 to August 1999, Mr. Britto served as Director of Business Development. Mr. Britto joined Amazon.com in June 1999 as part of the acquisition of Accept.com, which he co-founded in October 1998, and for which he served as a Vice President. From October 1994 through October 1998, Mr. Britto was Executive Vice President of Credit Policy at FirstUSA Bank, where he was responsible for their credit risk management practice. Prior to that, he served as Senior Vice President of Risk Management at NationsBank. Mr. Britto received an M.S. in Operations Research and a B.S. in Industrial Engineering and Operations Research from the University of California at Berkeley.

Richard L. Dalzell. Mr. Dalzell has served as Senior Vice President, Worldwide Architecture & Platform Software, and Chief Information Officer since November 2001. From October 2000 until November 2001, Mr. Dalzell was Senior Vice President and Chief Information Officer and prior to that, from joining Amazon.com in August 1997 until October 2000, he was Vice President and Chief Information Officer. From February 1990 to August 1997, Mr. Dalzell held several management positions within the Information Systems Division at Wal-Mart Stores, Inc., including Vice President of Information Systems from January 1994 to August 1997. From 1987 to 1990, Mr. Dalzell acted as the Business Development Manager for E-Systems, Inc. Prior to joining E-Systems, Inc. he served seven years in the United States Army as a teleprocessing officer. Mr. Dalzell received a B.S. in Engineering from the United States Military Academy, West Point.

Warren C. Jenson. Mr. Jenson joined Amazon.com in September 1999 as Senior Vice President and Chief Financial Officer. Before joining Amazon.com, Mr. Jenson was the Chief Financial Officer and Executive Vice President for Delta Air Lines from April 1998 to September 1999. From September 1992 to April 1998, Mr. Jenson served as Chief Financial Officer and Senior Vice President for the National Broadcasting Company (NBC), a subsidiary of General Electric, and participated in the development of MSNBC, the cable-Internet joint news venture between NBC and Microsoft. Mr. Jenson earned his Masters of Accountancy—Business Taxation, and B.S. in Accounting from Brigham Young University.

Diego Piacentini. Mr. Piacentini has served as Senior Vice President, Retail & Marketing, since November 2001. From joining Amazon.com in February 2000 until November 2001, Mr. Piacentini was Senior Vice President and General Manager, International. From April 1997 until joining Amazon.com, Mr. Piacentini was Vice President and General Manager, Europe, of Apple Computer, Inc., with responsibility for Apple Computer's operations in Europe, the Middle East and Africa. From April 1996 to April 1997, Mr. Piacentini was European Sales Director of Apple Computer, Inc. From May 1995 until April 1996, Mr. Piacentini was General Manager of Apple Computer's Italy operations, and before that, from September 1994 to May 1995, Mr. Piacentini was Apple Computer's Sales Director for Italy. Mr. Piacentini joined Apple Computer in 1987. Prior to that time he held a financial management position at Fiatimpresit in Italy. Mr. Piacentini received a degree in Economics from Bocconi University in Milan, Italy.

John D. Risher. Mr. Risher has served as Senior Vice President, Worldwide Application Software, since November 2001. From February 2000 until November 2001, Mr. Risher was Senior Vice President, U.S. Stores. Mr. Risher joined Amazon.com in February 1997 as Vice President of Product Development, a position he held until November 1997, when he was named Senior Vice President of Product Development. From July 1991 to February 1997, Mr. Risher held a variety of marketing and project management positions at Microsoft Corporation, including Team Manager for Microsoft Access and Founder and Product Unit Manager for MS Investor, Microsoft's Web site for personal investment. Mr. Risher received his B.A. in Comparative Literature from Princeton University and his M.B.A. from Harvard Business School. As previously announced in November 2001, Mr. Risher has resigned from Amazon.com, effective March 2002.

Jeffrey A. Wilke. Mr. Wilke has served as Senior Vice President, Worldwide Operations and Customer Service, since January 2002. From October 2000 until January 2002, Mr. Wilke was Senior Vice President, Operations, and prior to that he had been Vice President and General Manager, Operations, since joining Amazon.com in September 1999. Previously, Mr. Wilke held a variety of positions at AlliedSignal from 1993 to 1999, including Vice President and General Manager of the Pharmaceutical Fine Chemicals unit from March 1999 to September 1999 and General Manager of the Carbon Materials and Technologies unit from August 1997 to February 1999. Prior to his employment at AlliedSignal, he was an information technology consultant with Andersen Consulting. He received a B.S.E. in chemical engineering from Princeton University and has an M.B.A. and Master of Science in chemical engineering from the Massachusetts Institute of Technology.

L. Michelle Wilson. Ms. Wilson has served as Senior Vice President, Human Resources, General Counsel and Secretary since March 2001. She served as Vice President, General Counsel and Secretary from July 1999 until March 2001. Ms. Wilson joined Amazon.com in March 1999 as Associate General Counsel, Mergers and Acquisitions and Finance. From January 1995 until March 1999, she was a partner in the law firm of Perkins Coie LLP. Ms. Wilson received a J.D. from the University of Chicago Law School and a B.A. in Finance from the University of Washington.

Board of Directors

Name	Age	Position
Jeffrey P. Bezos	38	President, Chief Executive Officer and Chairman of the Board
Tom A. Alberg	61	Managing Director of Madrona Venture Group
Scott D. Cook	49	Chairman of the Executive Committee of Intuit, Inc.
L. John Doerr	50	General Partner, Kleiner Perkins Caufield & Byers
Mark S. Hansen	47	Chairman and CEO of Fleming Companies, Inc.
Patricia Q. Stonesifer	45	President and Co-Chair of the Bill & Melinda Gates Foundation

Item 2. ***Properties***

We do not own any real estate. Our principal office facilities in the U.S. are located in several leased facilities in Seattle, Washington under leases that expire at various times through April 2011. Our office facilities in the U.S. comprise a total of 772,000 square feet, of which we currently occupy 539,000 square feet.

Our U.S. warehousing and fulfillment operations are housed in six fulfillment centers located in New Castle, Delaware; Fernley, Nevada; Coffeyville, Kansas; Lexington, Kentucky; Campbellsville, Kentucky; and Grand Forks, North Dakota. These fulfillment centers comprise a total of approximately 3.12 million square feet. The New Castle, Delaware fulfillment center lease expires in October 2002, and the remaining fulfillment center leases expire from 2008 through 2015. We also have several smaller facilities located near our fulfillment centers that we use for off-site storage and shipping; these are relatively short-term leases for space that fluctuates from a total of 340,000 to 710,000 square feet.

Our U.S. customer service operations utilize 76,000 square feet of office space and are located in Tacoma, Washington, Huntington, West Virginia and Grand Forks, North Dakota. The lease terms of these facilities expire in January 2006, April 2010 and November 2008, respectively.

Our data-center facilities are located in Washington state and Virginia with 120,000 combined square feet. These facilities are under leases that expire in February 2004, and September 2009, respectively.

We lease additional properties outside the U.S., including approximately 192,000 square feet of office space in Germany, France, Japan and the United Kingdom (of which we currently occupy 141,000 square feet);

833,000 combined square feet of available fulfillment center space in Germany, France and the United Kingdom; and 54,000 combined square feet of customer service space in Japan, the United Kingdom and Germany. The fulfillment centers in Germany, the United Kingdom, and France are located in Bad Hersfeld, Marston Gate, and Orleans, respectively, and the lease terms expire in December 2009, March 2025, and March 2009, respectively.

In January 2001, we closed our fulfillment center in McDonough, Georgia; closed our customer service center in Seattle, Washington; and decided to operate seasonally (as necessary) our fulfillment center in Seattle, Washington. The McDonough and Seattle fulfillment centers are still under lease and total 893,000 square feet.

We believe our properties are suitable and adequate for our present and anticipated near term needs.

Item 3. *Legal Proceedings*

As previously disclosed in our Quarterly Report on Form 10-Q for the third quarter of 2000, we have received informal inquiries from the staff of the Securities and Exchange Commission Staff (the "SEC") with respect to the accounting treatment and disclosures for some of our initial strategic alliances and have been cooperating with the SEC staff in responding to those inquiries. We reviewed our accounting treatment for the transactions with our independent auditors and the SEC staff, and we believe our accounting treatment and disclosures were appropriate. The SEC staff recently notified us that it believes the other party to one such transaction, Ashford.com, improperly reported the resolution of a business dispute with us, and that it is considering whether the Company, or any of its officers or employees may have facilitated Ashford.com's conduct. While there can be no assurance that the SEC will not pursue an enforcement action, we believe our actions at all times were proper and that this matter will not materially affect our results of operations or financial condition.

On April 12, 2001, we received a request from the SEC staff for the voluntary production of documents and information concerning, among other things, previously reported sales of our common stock by Jeffrey Bezos on February 2 and 5, 2001. We are cooperating with the SEC staff's continuing inquiry.

A number of purported class action complaints were filed by holders of our equity and debt securities against us, our directors and certain of our senior officers during 2001, in the United States District Court for the Western District of Washington, alleging violations of the Securities Act of 1933 (the "1933 Act") and/or the Securities Exchange Act of 1934 (the "1934 Act"). On October 5, 2001, plaintiffs in the 1934 Act cases filed a consolidated amended complaint alleging that we, together with certain of our officers and directors and certain third-parties, made false or misleading statements during the period from October 29, 1998 through July 23, 2001 concerning our business, financial condition and results, inventories, future prospects, and strategic alliance transactions. The 1933 Act complaint alleges that the defendants made false or misleading statements in connection with our February 2000 offering of the 6.875% PEACS. The complaints seek recissionary and/or compensatory damages and injunctive relief against all defendants. We dispute the allegations of wrongdoing in these complaints and intend to vigorously defend ourselves in these matters.

Depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, future results of operations, financial position or cash flows in a particular period.

From time to time, we are subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights, patents and other intellectual property rights. We currently are not aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition or operating results.

Item 4. *Submission of Matters to a Vote of Security Holders*

No matters were submitted for a vote of our stockholders during the fourth quarter of the year ended December 31, 2001.

PART II

Item 5. *Market for the Registrant's Common Stock and Related Stockholder Matters*

Market Information

Our common stock is traded on the Nasdaq National Market under the symbol "AMZN." The following table sets forth the high and low sale prices for the common stock for the periods indicated, as reported by the Nasdaq National Market.

	High	Low
Year ended December 31, 2000		
First Quarter	$91.50	$58.44
Second Quarter	68.63	32.47
Third Quarter	49.63	27.88
Fourth Quarter	40.88	14.88
Year ended December 31, 2001		
First Quarter	$21.88	$10.00
Second Quarter	17.56	8.37
Third Quarter	16.98	5.97
Fourth Quarter	12.24	6.01

Holders

As of January 10, 2002, there were 4,013 stockholders of record of our common stock, although there is a much larger number of beneficial owners.

Dividends

We have never declared or paid cash dividends on our common stock. We intend to retain all future earnings to finance future growth and, therefore, do not anticipate paying any cash dividends in the foreseeable future. In addition, we are restricted from paying cash dividends under our Senior Discount Notes. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

Recent Sales of Unregistered Securities

None.

Item 6. *Selected Consolidated Financial Data*

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto and the information contained herein in Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations." Historical results are not necessarily indicative of future results.

	As of and for the Years Ended December 31,				
	2001	2000	1999	1998 (1)	1997 (1)
	(in thousands, except per share data)				
Statements of Operations Data:					
Net sales	$ 3,122,433	$ 2,761,983	$1,639,839	$ 609,819	$147,787
Gross profit	798,558	655,777	290,645	133,664	28,818
Loss from operations	(412,257)	(863,880)	(605,755)	(109,055)	(32,595)
Interest income	29,103	40,821	45,451	14,053	1,901
Interest expense	(139,232)	(130,921)	(84,566)	(26,639)	(326)
Net loss	(567,277)	(1,411,273)	(719,968)	(124,546)	(31,020)
Basic and diluted net loss per share (2)	$ (1.56)	$ (4.02)	$ (2.20)	$ (0.42)	$ (0.12)
Shares used in computation of basic and diluted net loss per share (2)	364,211	350,873	326,753	296,344	260,682
Balance Sheet Data:					
Cash and cash equivalents	$ 540,282	$ 822,435	$ 133,309	$ 71,583	$110,119
Marketable securities	456,303	278,087	572,879	301,862	15,256
Total assets	1,637,547	2,135,169	2,465,850	648,460	149,844
Long-term debt	2,156,133	2,127,464	1,466,338	348,140	76,702
Stockholders' Equity (Deficit)	(1,440,000)	(967,251)	266,278	138,745	28,591

(1) Reflects restatement for 1998 business acquisition accounted for under the pooling-of-interests method.

(2) For further discussion of loss per share, see Notes 1 and 10 of Notes to Consolidated Financial Statements.

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

Forward-Looking Statements

This Annual Report on Form 10-K includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this Annual Report on Form 10-K are forward looking. We use words such as anticipates, believes, expects, future, intends and similar expressions to identify forward-looking statements. Forward-looking statements reflect management's current expectations and are inherently uncertain. Our actual results may differ significantly from management's expectations. The following discussion includes forward-looking statements regarding expectations of future pro forma operating profitability and loss, net sales, cash flows from operations and free cash flows, all of which are inherently difficult to predict. Actual results could differ materially for a variety of reasons, including, among others, the rate of growth of the economy in general, the Internet and online commerce, customer spending patterns, the amount that we invest in new business opportunities and the timing of those investments, the mix of products sold to customers, the mix of net sales derived from products as compared with services, risks of inventory management, the degree to which we enter into, maintain and develop relationships with third party sellers and other strategic transactions, fluctuations in the value of securities and non-cash payments we receive in connection with such transactions, foreign currency exchange risks, seasonality, international growth and expansion, and risks of fulfillment throughput and productivity. These risks and uncertainties, as well as other risks and uncertainties that could cause our actual results to differ significantly from management's expectations, are described in greater detail in Item 1 of Part I, "Business—Additional Factors That May Affect Future Results," which, along with the following discussion, describes some, but not all, of the factors that could cause actual results to differ significantly from management's expectations.

Results of Operations

Net Sales

Net sales include the selling price of consumer products sold by us, less promotional gift certificates and sales returns; outbound shipping charges billed to our customers; commissions and other amounts earned from sales of new and used products on Amazon Marketplace, Auctions and zShops; amounts earned (fixed fees, sales commissions, per-unit activity fees, or some combination thereof) for sales of retail products through our Merchant@amazon.com Program, including our strategic alliances with Toysrus.com and Circuit City; the selling price of consumer products sold by us through our Syndicated Stores program, such as *www.borders.com*; amounts earned (fixed fees, sales commissions, per-unit activity fees, or some combination thereof) in connection with our Merchant Program, such as Target.com, which is scheduled to launch in the second half of 2002; commissions earned from third parties who utilize our technology services such as search, browse and personalization; and amounts earned for miscellaneous marketing and promotional agreements.

Net sales were $3.12 billion, $2.76 billion and $1.64 billion for 2001, 2000 and 1999, respectively, representing annual growth rates of 13% and 68% for 2001 and 2000, respectively. The reduced annual growth rate in our net sales is reflective of several factors, including the larger base comparison that results from our rapid growth in previous years, a shift in the source of our product sales towards new and used products sold through Amazon Marketplace, and declines in general economic conditions.

Net sales for our U.S. Books, Music and DVD/Video segment were $1.69 billion, $1.70 billion and $1.31 billion for 2001, 2000 and 1999, respectively. These results represent an annual decline in net sales for our U.S. Books, Music and DVD/Video segment of 1% for 2001, and an annual growth rate of 30% for 2000. This segment includes retail sales from *www.amazon.com* of books, music and DVDs/video products and for magazine subscriptions. This segment also includes commissions from sales of these products, new or used, through Amazon Marketplace and product revenues from stores offering these products through our Syndicated Stores Program, such as *www.borders.com*. Amazon Marketplace represented 12% of total orders in our U.S. Retail segments, primarily relating to our U.S. Books, Music and DVD/Video segment, during 2001. Amazon Marketplace orders were nominal in the prior year. The slowing annual growth rate reflects several factors including a shift in the source of our product sales towards new and used products sold through Amazon Marketplace, a continuing focus on balancing revenue growth with achieving operating profitability, and declines in general economic conditions.

Net sales for our U.S. Electronics, Tools and Kitchen segment were $547 million, $484 million and $151 million for 2001, 2000 and 1999, respectively. These results represent an annual growth rate of 13% for 2001. Since our U.S. Electronics, Tools and Kitchen segment began in the second half of 1999, annual growth rates for 2000 are not meaningful. This segment includes *www.amazon.com* retail sales of electronics, computers, camera and photo items, software, computer and video games, cell phones and service, tools and hardware, outdoor living items, kitchen and houseware products, toys and video games sold other than through our strategic alliance with Toysrus.com, Inc., as well as catalog sales of toys, tools and hardware. This segment also includes commissions from sales of these products, new or used, through Amazon Marketplace and commissions or other amounts earned from offerings of these products by third-party sellers through our Merchant@amazon.com Program, such as our strategic alliance with Circuit City. Excluding online sales of toys and video games which, since September 2000, have been sold at *www.amazon.com* primarily through our strategic alliance with Toysrus.com and reported in our Services segment, annual growth rates for our U.S. Electronics, Tools and Kitchen segment would have been 28% for 2001. Annual growth in net sales for our U.S. Electronics, Tools and Kitchen segment reflects increases in units sold by our electronics, kitchen and housewares, and outdoor living stores in comparison with 2000, offset by the effects of declines in average selling prices per unit, declines in general economic conditions, and the fact that most online sales of toys and video games are now sold through our strategic alliance with Toysrus.com and the corresponding revenue is therefore reported in our Services segment.

Net sales for our Services segment were $225 million, $198 million and $13 million for 2001, 2000 and 1999, respectively. These results represent an annual growth rate of 13% for 2001. Since we began offering services in late 1999, annual growth rates for 2000 are not meaningful. This segment consists of commissions, fees and other amounts earned from our business-to-business strategic alliances, including our Merchant Program and, to the extent product categories are not also offered by us through our online retail stores, our Merchant@amazon.com Program, as well as our strategic alliance with America Online, Inc. This segment also includes Auctions, zShops and Payments, and miscellaneous marketing and promotional agreements. The increase in net sales from our Services segment during 2001 was primarily associated with our Toysrus.com strategic alliance, which commenced September 2000, offset by the conclusion of certain of our initial strategic marketing relationships. Included in service revenues are equity-based service revenues of $27 million, $79 million and $7 million for 2001, 2000 and 1999, respectively. Equity-based service revenues result from private and public securities received by us and amortized into our results of operations over the period services are performed.

Net sales for our International segment were $661 million, $381 million and $168 million for 2001, 2000 and 1999, respectively. These results represent annual growth rates of 74% and 127% for 2001 and 2000, respectively. This segment includes all retail sales of our four internationally-focused Web sites: *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr* and *www.amazon.co.jp*. These international sites share a common Amazon experience, but are localized in terms of language, products, customer service and fulfillment. This segment includes commissions and other amounts earned from offerings of these products by third party sellers through our Merchant@amazon.com Program, and product revenues from stores offering these products through our internationally-focused Syndicated Stores Program, such as *www.waterstones.co.uk*. The annual growth rate in 2001 reflects increases in units sold by our *www.amazon.de* and *www.amazon.co.uk* sites, as well as the launch of our *www.amazon.fr* and *www.amazon.co.jp* sites during the second half of 2000. The annual growth rate for our International segment during 2000 primarily relates to sales from our *www.amazon.co.uk, www.amazon.de* Web sites, and are reflective of the early stage of their operation with relatively smaller comparison sales bases. Sales to customers outside the United States, including export sales from *www.amazon.com* (which are reported in the corresponding U.S. segment), represented, as a percentage of consolidated net sales, approximately 29% and 22% for 2001 and 2000, respectively.

Shipping revenue, which consists of outbound shipping charges to our customers, across all segments was $357 million, $339 million and $239 million for 2001, 2000 and 1999, respectively. Shipping revenue generally corresponds with unit sales levels, offset by our periodic free and the reduced-shipping promotions. In January 2002, we introduced a new shipping option at *www.amazon.com*, offering free shipping for certain orders of $99 or more. We offer or may offer a similar shipping option for our internationally-focused Web sites. The effect of this shipping offer will reduce shipping revenue as a percentage of sales, and will cause our gross margins on retail sales to decline.

We expect net sales to be between $775 million and $825 million for the quarter ending March 31, 2002, an increase of between 11% and 18%, and net sales to increase 10% or more in 2002 compared to 2001. However, any such projections are subject to substantial uncertainty. See Item 1 of Part I, "Business—Additional Factors that May Affect Future Results."

Gross Profit

Gross profit is net sales less the cost of sales, which consists of the purchase price of consumer products sold by us, inbound and outbound shipping charges to us, packaging supplies, and certain costs associated with our service revenues. Costs associated with our service revenues classified as cost of services generally include fulfillment-related costs to ship products on behalf of third-party sellers, costs to provide customer service, credit card fees and other related costs.

We are currently considering prospectively changing our inventory costing method to the first-in first-out (FIFO) method of accounting which would, if applied, become effective January 1, 2002. We are currently determining the effect this change would have on our financial statements, whether this change would be significant, and whether it meets preferability requirements under generally accepted accounting principles. We believe the change would facilitate our record keeping process, and in turn, our ability to provide fulfillment services to third-party companies as part of our services offering, and would result in increased consistency with others in our industry. Although we have not yet completed our analysis of this potential change, based on our preliminary analysis, we do not anticipate the effect of such change, if applied, to have a significant cumulative effect on results of operations in the fiscal year of adoption, nor on amounts previously reported as inventory or "Cost of sales" as if the FIFO method had been applied in previous years.

Gross profit was $799 million, $656 million and $291 million for 2001, 2000 and 1999, respectively, representing increases of 22% and 126% for 2001 and 2000, respectively. Gross margin was 26%, 24% and 18% for 2001, 2000 and 1999, respectively. Increases in the absolute dollars of gross profit during each period corresponds with increases in units sold, improvements in inventory management, and improved product sourcing. Excluding the results of our Services segment, gross margin would have been 23%, 21% and 17%, respectively.

Gross profit for our U.S. Books, Music and DVD/video segment was $453 million, $417 million and $263 million for 2001, 2000 and 1999, respectively, which represents increases of 9% and 59% for 2001 and 2000, respectively. Gross margin was 27%, 25% and 20% for 2001, 2000 and 1999, respectively. Improvements in gross margins during 2001 correspond with improvements in inventory management, continued improvements in product sourcing and, to a lesser extent, the higher margin sales of new and used products sold through Amazon Marketplace, offset by higher customer discounts. Improvements in gross margin during 2000 in comparison to 1999 reflect improvements in inventory management and product sourcing, and lower customer discounts offered.

Gross profit for our U.S. Electronics, Tools and Kitchen segment was $78 million and $45 million for 2001 and 2000, respectively, representing an increase of 76% for 2001. This segment reported a gross loss of $20 million for 1999. Gross margin was 14% and 9% for 2001 and 2000, respectively, and negative 13% during 1999. Improvements in gross profit for each of the comparative periods corresponds with increases in net sales, improvements in product sourcing, the introduction of new product categories, and improvements in inventory management. Also, since most online sales of toys and video games, since September 2000, are sold through our strategic alliance with Toysrus.com, the corresponding gross profit is therefore reported in our Services segment.

Gross profit for our Services segment was $126 million, $116 million and $12 million for 2001, 2000 and 1999, respectively, which represents an increase of 9% for 2001. Since we began offering services in late 1999, annual growth rate for 2000 is not meaningful. Costs associated with our service revenues classified as cost of services generally include fulfillment-related costs to ship products on behalf of third-party sellers, costs to provide customer service, credit card fees and other related costs. Gross margin was 56%, 59% and 93% for 2001, 2000 and 1999, respectively. Gross profit from our Services segment largely corresponds with revenues from our business-to-business strategic alliances, which includes our Merchant Program and, to the extent product categories are not also offered by us through our online retail stores, the Merchant@amazon.com Program, as well as our strategic alliance with America Online, Inc. Gross profit for our Services segment also includes amounts earned through Auctions, zShops and Payments, and miscellaneous marketing and promotional agreements. The decline in gross margin from our Services segment for 2001 relates to service costs classified in cost of sales resulting from the shift in the mix of our strategic relationships towards alliances that incorporate a broader range of services, including fulfillment. Also contributing to the decline in Services gross margin was a reduction in high-margin marketing and promotional agreements. Included in service revenues are equity-based service revenues of $27 million, $79 million and $7 million for 2001, 2000 and 1999, respectively. Equity-based service revenues result from private and public securities received by us and amortized into our results of operations over the period services are performed.

Gross profit for our International segment was $141 million, $77 million and $36 million for 2001, 2000 and 1999, respectively, which represents increases of 82% and 118% for 2001 and 2000, respectively. Gross margin was 21%, 20% and 21% for 2001, 2000 and 1999, respectively. The increase in our absolute gross profit dollars during 2001 and 2000 reflects increases in units sold by our *www.amazon.de* and *www.amazon.co.uk* sites in comparison with the same periods in the prior year, as well as the launch of our *www.amazon.fr* and *www.amazon.co.jp* sites during the second half of 2000. The increase in our absolute gross profit dollars during 1999 relates primarily to increases in units sold by our *www.amazon.de* and *www.amazon.co.uk* sites in comparison with the same periods in the prior year.

Shipping gross loss across all segments was $19 million and $1 million for 2001 and 2000, respectively, and shipping gross profit was $12 million for 1999. The gross loss in shipping in 2001 and 2000 was due, in part, to a higher revenue mix from our business units in countries that offer free shipping or product lines that involve low-margin shipping, as well as selective free-shipping promotions in the U.S. Shipping losses incurred from our internationally-focused Web sites, which are included in shipping results across all segments, were $14 million, $6 million and $4 million for 2001, 2000 and 1999, respectively. We continue to measure our shipping results relative to their effect on our overall financial results, with the viewpoint that shipping promotions are an effective promotional tool. In January 2002, we introduced a new shipping option at *www.amazon.com*, offering free shipping for certain orders of $99 or more. We offer or may offer a similar shipping option for our internationally-focused Web sites. The effect of this shipping offer will reduce shipping revenue as a percentage of sales, and will negatively affect gross margins on our retail sales.

Fulfillment

Fulfillment costs represent those costs incurred in operating and staffing our fulfillment and customer service centers, including costs attributable to receiving, inspecting and warehousing inventories; picking, packaging and preparing customers' orders for shipment; credit card fees and bad debt costs; and responding to inquiries from customers. Fulfillment costs also include amounts paid to third-party co-sourcers who assist us in fulfillment and customer service operations. Certain fulfillment-related costs to ship products on behalf of third-party sellers, excluding those costs associated with Syndicated Stores, are classified as cost of sales rather than fulfillment. Fulfillment costs were $374 million, $415 million and $237 million for 2001, 2000 and 1999, respectively, representing 12%, 15% and 14% of net sales for the corresponding periods. Excluding net sales from our services segment, fulfillment costs represent 13%, 16% and 15% of net sales for 2001, 2000 and 1999, respectively. The improvement in fulfillment costs as a percentage of net sales during 2001 in comparison to 2000 results from improvements in productivity, the increase in units fulfilled helping to leverage our fixed-cost base, a decline in customer service contacts resulting from improvements in our customer self-service features available on our Web sites, improved balancing of inventory throughout our network that resulted in fewer split shipments, and our operational restructuring announced in January 2001. Our operational restructuring included the closure of our fulfillment center in McDonough, Georgia; the seasonal closure of our Seattle, Washington fulfillment center, which was not utilized during the 2001 holiday season; and the closure of our customer service centers in The Hague, Netherlands and Seattle, Washington.

Marketing

Marketing expenses consist of advertising, promotional and public relations expenditures, and payroll and related expenses for personnel engaged in marketing and selling activities. Marketing expenses, net of co-operative marketing reimbursements, were $138 million, $180 million and $176 million, representing 4%, 7% and 11% of net sales for 2001, 2000 and 1999, respectively. Declines in expense for marketing-related activities in comparison to prior years reflect management efforts to target advertising spending in channels considered most effective at driving incremental net sales (such as targeted on-line advertising through various Web portals and our Associates Program), an increase in co-operative marketing allowances during 2001, and the general decline in market costs for advertising-related promotions. In January 2002 we introduced a new shipping option at *www.amazon.com*, offering free shipping for certain orders of $99 or more. We offer or may offer a similar shipping option for our internationally-focused Web sites. Although marketing expenses do not include our free and reduced shipping offers, we view such promotions as an effective marketing tool.

Technology and Content

Technology and content expenses consist principally of payroll and related expenses for development, editorial, systems and telecommunications operations personnel and consultants; systems and telecommunications infrastructure; and costs of acquired content, including freelance reviews. Technology and content expense was $241 million, $269 million and $160 million for 2001, 2000 and 1999, respectively, representing 8%, 10% and 10% of net sales for the corresponding periods, respectively. The decline in absolute dollars spent during 2001 in comparison to the prior year primarily reflect our migration to a technology platform that utilizes a less-costly technology infrastructure, as well as improved expense management and general price reductions in most expense categories, including data and telecommunication services, due to market overcapacity. The increase in absolute dollars spent during 2000 in comparison to 1999 primarily reflects past investments in our systems and telecommunications infrastructure to support the continual enhancements to our Web site, as well as costs associated with launching our *www.amazon.fr* and *www.amazon.co.jp* sites during 2000. We expect to continue to invest in technology and improvements in our Web sites during 2002, which may include, but is not limited to, offering additional Web site features and product categories to our customers and implementing additional strategic alliances, as well as potentially continuing our international expansion.

General and Administrative

General and administrative expenses consist of payroll and related expenses for executive, finance and administrative personnel, recruiting, professional fees and other general corporate expenses. General and administrative expenses were $90 million, $109 million and $70 million for 2001, 2000 and 1999, respectively, representing 3%, 4% and 4% of net sales for the corresponding periods, respectively. The decline in absolute dollars of general and administrative costs during 2001 in comparison with 2000 was primarily due to our operational restructuring plan announced in January 2001, which reduced the number of positions in corporate and administrative roles and consolidated our corporate office locations. The increase in general and administrative costs during 2000 in comparison to 1999 relates primarily to increases in personnel, facility-related costs associated with our corporate expansion, and professional fees associated with general corporate matters.

Stock-Based Compensation

Stock-based compensation includes stock-based charges resulting from variable accounting treatment of certain stock options, option-related deferred compensation recorded at our initial public offering, as well as certain other compensation and severance arrangements. Stock-based compensation also includes the portion of acquisition-related consideration conditioned on the continued tenure of key employees of certain acquired businesses, which must be classified as compensation expense rather than as a component of purchase price under accounting principles generally accepted in the U.S. Stock-based compensation was $5 million, $25 million and $31 million for 2001, 2000 and 1999, respectively. The declines in stock-based compensation during 2001 and 2000 in comparison to the prior respective years resulted from the full vesting and corresponding full recognition of deferred stock-based compensation relating to employees of certain acquired businesses.

The following table shows the amounts of stock-based compensation that would have been recorded under the following categories had stock-based compensation not been separately stated on the statements of operations.

	For the Years Ended December 31,		
	2001	2000	1999
		(in thousands)	
Fulfillment	$ 481	$ (1,606)	$ 188
Marketing	690	(858)	3,957
Technology and content	2,723	28,253	25,322
General and administrative	743	(992)	1,151
	$4,637	$24,797	$30,618

During the first quarter of 2001, we offered a limited non-compulsory exchange of employee stock options. The exchange resulted in the voluntary cancellation of employee stock options to purchase 31 million shares of common stock with varying exercise prices in exchange for 12 million employee stock options with an exercise price of $13.375. The option exchange offer resulted in variable accounting treatment for, at the time of the exchange, approximately 15 million stock options, which includes options granted under the exchange offer and 3 million options, with a weighted average exercise price of $52.41, that were subject to the exchange offer but were not exchanged. Variable accounting will continue until all options subject to variable accounting treatment are exercised, cancelled or expired. At December 31, 2001, approximately 12 million options remain under variable accounting treatment, which includes 11 million options granted under the exchange offer, which, if not previously exercised, will expire on September 30, 2003, and 1 million options, with a weighted average exercise price of $39.61, that were subject to the exchange offer but were not exchanged.

Variable accounting treatment will result in unpredictable and potentially significant charges or credits recorded to “Stock-based compensation,” dependent on fluctuations in quoted prices for our common stock. We have quantified the hypothetical effect on “Stock-based compensation” associated with increases in the quoted price of our common stock using a sensitivity analysis for our outstanding stock options subject to variable accounting at December 31, 2001. We have provided this information to provide additional insight into the potential volatility we may experience in the future in our results of operations to the extent that the quoted price for our common stock rises above $13.375. This sensitivity analysis is not a prediction of future performance of the quoted prices of our common stock. Using the following hypothetical increases in the market price of our common stock above $13.375, our hypothetical cumulative compensation expense at December 31, 2001 resulting from variable-accounting treatment would have been as follows:

Hypothetical Increase Over $13.375	Hypothetical Market Price per Share	Hypothetical Cumulative Compensation Expense
		(in thousands)
5%	$14.04	$ 6,788
10%	$14.71	$ 12,578
15%	$15.38	$ 18,369
25%	$16.72	$ 29,950
50%	$20.06	$ 58,902

If at the end of any fiscal quarter the quoted price of our common stock is lower than the quoted price at the end of the previous fiscal quarter, or to the extent previously-recorded amounts relate to unvested portions of options that were cancelled, compensation expense associated with variable accounting will be recalculated using the cumulative expense method and may result, in certain circumstances, in a net benefit to our results of operations.

Amortization of Goodwill and Other Intangibles

Amortization of goodwill and other intangibles was $181 million, $322 million and $215 million for 2001, 2000 and 1999, respectively. During the fourth quarter of 2000, we recorded an impairment loss of $184 million on goodwill and other intangibles relating to certain of our 1999 acquisitions. This impairment loss reduced our recorded basis in goodwill and other intangibles and had the effect of reducing amortization expense during 2001. In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," which requires use of a nonamortization approach to account for purchased goodwill and certain intangibles, effective January 1, 2002. Under this nonamortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead will be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles is more than its fair value. We expect the adoption of this accounting standard will result in approximately $25 million of other intangible assets being subsumed into goodwill, and will have the effect of substantially reducing our amortization of goodwill and intangibles commencing January 1, 2002. Transitional impairments, if any, are not expected to be material; however, impairment reviews may result in future periodic write-downs.

Restructuring-Related and Other

Restructuring-related and other expenses were $182 million, $200 million and $8 million for 2001, 2000 and 1999, respectively. In the first quarter of 2001, we announced and began implementation of our operational restructuring plan to reduce operating costs, streamline our organizational structure, and consolidate certain of our fulfillment and customer service operations. This initiative involved the reduction of employee staff by approximately 1,300 positions in managerial, professional, clerical, technical and fulfillment roles; consolidation of our Seattle, Washington corporate office locations; closure of our McDonough, Georgia fulfillment center; seasonal operation of our Seattle, Washington fulfillment center (if necessary); closure of our customer service centers in Seattle, Washington and The Hague, Netherlands; and migration of a large portion of our technology infrastructure to a new operating platform, which entails ongoing lease obligations for technology infrastructure no longer being utilized. Each component of the restructuring plan has been substantially completed. As of December 31, 2001, 1,327 employees had been terminated, and actual termination benefits paid were $12 million.

Costs that relate to ongoing operations are not part of restructuring charges and are not included in "Restructuring-related and other." In accordance with EITF Issue No. 96-9, "Classification of Inventory Markdowns and Other Costs Associated with a Restructuring," all inventory adjustments that may result from the closure or seasonal operation of our fulfillment centers are classified in "Cost of goods sold" on the statements of operations. As of December 31, 2001, there have been no significant inventory write downs resulting from the restructuring, and none are anticipated.

For the year ended December 31, 2001, the charges associated with the restructuring were as follows (in thousands):

Asset impairments	$ 68,528
Continuing lease obligations	87,049
Termination benefits	14,970
Broker commissions, professional fees and other miscellaneous restructuring costs	11,038
	$181,585

Asset impairments primarily relate to the closure of the McDonough, Georgia fulfillment center, the write-off of leasehold improvements in vacated corporate office space, and the decline in the fair value of assets in the Seattle, Washington fulfillment center. For assets to be disposed of, we estimated the fair value based on expected salvage value less costs to sell. For assets held for continued use, the decline in fair value was measured using discounted estimates of future cash flows. At December 31, 2001 the carrying amount of assets held for disposal was not significant.

Continuing lease obligations primarily relate to heavy equipment previously used in the McDonough, Georgia fulfillment center, vacated corporate office space, technology infrastructure no longer being utilized, and the unutilized portion of our back-up data center. We are actively seeking third parties to sub-lease abandoned equipment and facilities. Amounts expensed represent estimates of undiscounted future cash outflows, offset by anticipated third-party sub-leases. At December 31, 2001, we remain obligated under gross lease obligations of $121 million associated with our operational restructuring and we anticipate receiving sub-lease income of $68 million to offset these obligations, of which $17 million is to be received under non-cancelable subleases. Given the uncertainty of estimating future sub-lease rentals, actual results may differ from estimates which may result in significant additional expenses for us and corresponding net cash outflow above amounts expected.

Termination benefits are comprised of severance-related payments for all employees terminated in connection with the operational restructuring, as well as $2.5 million of our common stock contributed to a trust fund for the benefit of terminated employees. Termination benefits do not include any amounts for employment-related services prior to termination. Other restructuring costs include professional fees, decommissioning costs of vacated facilities, broker commissions and other miscellaneous expenses directly attributable to the restructuring.

At December 31, 2001, the accrued liability associated with the restructuring-related and other charges was $61 million and consisted of the following (in thousands):

	Balance at March 31, 2001	Subsequent Accruals, net	Non-Cash Settlements and Other Adjustments	Payments	Balance at December 31, 2001	Due Within 12 Months	Due After 12 Months
Lease obligations	$34,667	$52,738	$(2,675)	$(31,543)	$53,187	$35,578	$17,609
Termination benefits	8,445	113	(2,354)	(6,143)	61	61	—
Broker commissions, professional fees and other miscellaneous restructuring costs	4,121	5,052	1,559	(2,542)	8,190	5,159	3,031
	$47,233	$57,903	$(3,470)	$(40,228)	$61,438	$40,798	$20,640

Cash payments resulting from our operational restructuring during 2001 were $49 million. We anticipate the restructuring charges will result in the following net cash outflows (in thousands):

	Leases	Termination Benefits	Other	Total
Year Ending December 31,				
2002	$35,578	$ 61	$5,159	$40,798
2003	5,476	—	3,031	8,507
2004	2,016	—	—	2,016
2005	1,983	—	—	1,983
2006	2,068	—	—	2,068
Thereafter	6,066	—	—	6,066
Total estimated cash outflows	$53,187	$ 61	$8,190	$61,438

During 2000, we identified certain levels of impairment corresponding with the business-unit goodwill and other intangibles initially recorded in connection with the following acquisitions: Alexa Internet, Back to Basics Toys, Inc., Livebid, Inc., and the catalog and Internet assets of Acme Electric Motor Co. (Tool Crib). Accordingly, we recorded an impairment loss of $184 million. Also during 2000, we recorded an impairment loss of $11 million relating to the decline in fair value, measured using discounted estimates of future cash flows, of certain fixed assets. The fixed-asset impairment amount included $4 million, $3 million and $4 million of computers, equipment and software; leasehold improvements; and leased assets, respectively.

Other costs associated with our acquisition-related activities were $5 million and $8 million for 2000 and 1999, respectively. No such amounts were recorded during 2001.

Loss from Operations

Our loss from operations was $412 million, $864 million and $606 million for 2001, 2000 and 1999, respectively. The improvement in operating loss for 2001 in comparison with the prior period was primarily due to an increase in gross profit; a reduction in certain operating costs including fulfillment, marketing, technology and content, and general and administrative; and declines in charges such as amortization of goodwill and other intangibles.

Net Interest Expense and Other

Net interest expense and other, excluding "Other gains (losses), net," was $112 million, $100 million and $37 million for 2001, 2000 and 1999, respectively. Interest income was $29 million, $41 million and $45 million for 2001, 2000 and 1999, respectively. Interest expense was $139 million, $131 million and $85 million for 2001, 2000 and 1999. Other income and expense, consisting primarily of realized gains and losses on sales of marketable securities, miscellaneous state and foreign taxes and certain realized foreign-currency related transactional gains and losses, was an expense of $2 million and $10 million for 2001 and 2000, respectively, and a gain of $2 million for 1999. Interest income relates primarily to interest earned on fixed income securities and correlates with the average balance of those investments and prevailing interest rates. The increase in interest expense during 2001 in comparison with 2000 is primarily related to our February 2000 issuance of the 6.875% PEACS. Other components of interest expense include our February 1999 issuance of $1.25 billion of 4.75% Convertible Subordinated Notes due 2009 (the "4.75% Convertible Subordinated Notes"), and our May 1998 issuance of approximately $326 million gross proceeds of 10% Senior Discount Notes due 2008 (the "Senior Discount Notes"). At December 31, 2001, our total long-term indebtedness was $2.16 billion.

Other Gains (Losses), Net

Other gains (losses), net were recorded during 2001 and 2000, resulting in net costs of $2 million and $143 million, respectively. No comparable amounts were recorded during 1999. Other gains (losses), net consisted of the following:

	Years Ended December 31,	
	2001	2000
	(in thousands)	
Foreign-currency gains on 6.875% PEACS	$ 46,613	$ —
Losses on sales of Euro-denominated investments, net	(22,548)	—
Other-than-temporary impairment losses, equity investments	(43,588)	(188,832)
Contract termination by third parties	22,400	6,033
Net gains from acquisition of investments by third parties	784	40,160
Warrant fair-value remeasurements and other	(5,802)	—
	$ (2,141)	$(142,639)

Effective January 1, 2001, currency gains and losses arising from the remeasurement of the 6.875% PEACS's principal from Euros to U.S. dollars each period are recorded to "Other gains (losses), net" on our statements of operations. Prior to January 1, 2001, 6.875% PEACS's principal of 615 million Euros was designated as a hedge of equivalent amount of Euro-denominated investments classified as available-for-sale; accordingly, currency gains and losses on the 6.875% PEACS were recorded to "Accumulated other comprehensive loss" on our balance sheets as hedging offsets to currency gains and losses on the Euro-denominated investments. As the hedge does not qualify for hedge accounting under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," commencing January 1, 2001, the foreign currency change resulting from the portion of the 6.875% PEACS previously hedging the available-for-sale securities is now being recorded on our statements of operations. For 2001, the remeasurement of the 6.875% PEACS resulted in a gain of $47 million consisting of a $10 million gain reclassified from "Accumulated other comprehensive loss," and a $37 million gain attributable to remeasurement of the 6.875% PEACS during the period. We are unable to forecast or predict the loss or gain on our Euro-denominated debt that will result from fluctuations in foreign exchange rates in future periods; any such amounts may have a significant effect on our future reported results.

During 2001 and 2000, we recorded impairment losses, which totaled $44 million and $189 million, respectively, relating to other-than-temporary declines in certain of our equity investments. These impairments were recorded to reflect the investments at fair value as of the date of impairment. During 2001, our other-than-temporary declines in fair value of investments were associated with our investments in Webvan Group, Inc, Sotheby's Holdings, Inc., WeddingChannel.com, Inc., Ashford.com, Inc., Audible, Inc., drugstore.com, inc., and Angel II Investors, L.P. During 2000, our other-than-temporary declines in fair value of investments were associated with Audible, NextCard, Inc., Webvan, Ashford.com, Greg Manning Auctions, Inc, and Sotheby's. At December 31, 2001 we have no further loss exposure relating to our investment in Webvan.

In February 2001, we terminated our commercial agreement with Kozmo.com and recorded a non-cash gain of $22 million, representing the amount of unearned revenue associated with the contract. Since services had not yet been performed under the contract, no amounts associated with this commercial agreement were recognized in "Net sales" during any period. Furthermore, during 1999, we made a cash investment of $60 million to acquire preferred stock of Kozmo.com and accounted for our investment under the equity method of accounting. Pursuant to the equity method of accounting, we recorded our share of Kozmo.com losses, which, during 2000, reduced our basis in the investment to zero. Accordingly, when Kozmo.com announced its intentions to cease operations in April 2001, we did not have any further loss exposure relating to our investment. We will not recover any portion of our investment in Kozmo.com.

During 2000, we recorded a gain of $40 million relating to the acquisition of Homegrocer.com by Webvan, and a $6 million net gain relating to the bankruptcy of Living.com, Inc. that is comprised of a $14 million loss representing our remaining investment balance in Living.com and a $20 million gain relating to the unamortized portion of unearned revenue associated with the Living.com commercial agreement.

As of December 31, 2001, our recorded basis in equity securities was $41 million, including $13 million classified as "Marketable securities," $10 million classified as "Investments in equity-method investees," and $18 million classified as "Other equity investments."

Equity in Losses of Equity-Method Investees

Equity in losses of equity-method investees represents our share of losses of companies in which we have investments that give us the ability to exercise significant influence, but not control, over an investee. This influence is generally defined as an ownership interest of the voting stock of the investee of between 20% and 50%, although other factors, such as representation on our investee's Board of Directors and the effect of commercial arrangements, are considered in determining whether the equity method of accounting is appropriate. Equity-method losses were $30 million, $305 million and $77 million for 2001, 2000 and 1999, respectively. Equity-method losses declined during 2001 in comparison with 2000 because such losses reduced many of our underlying investment balances until the recorded basis was reduced to zero. Our basis in equity-method investments was $10 million, $52 million and $227 million at December 31, 2001, 2000 and 1999, respectively. During 2001, we issued $5 million of our common stock in exchange for an ownership interest that results in significant influence in Altura International, which operates Catalogcity.com. No cash investments were made in equity-method investees during 2001. As equity-method losses are only recorded until the underlying investments are reduced to zero, we expect, absent additional investments in the voting stock of third parties, equity-method losses to continue to decline in future periods in comparison with prior periods.

Income Taxes

We provided for current and deferred income taxes in state and foreign jurisdictions where our subsidiaries produce taxable income. As of December 31, 2001, we have a net deferred tax asset of $2 million, which consists primarily of state net operating losses. We have provided a full valuation allowance against the remaining portion of our deferred tax asset, consisting primarily of net operating losses, because of uncertainty regarding its future realization.

Net Loss

Net loss was $567 million, $1.4 billion and $720 million for 2001, 2000 and 1999, respectively. Although we reported net income of $5 million during the fourth quarter of 2001, we believe that this positive net income result is not predictive of future results or trends and should not be viewed as a material positive event for a variety of reasons. For example, excluding the foreign-currency gain associated with our 6.875% PEACS we would have reported a net loss in the fourth quarter of 2001. Additionally, we continue to be unable to forecast the effect on our future reported results of certain items, including the gain or loss associated with our 6.875% PEACS that will result from fluctuations in foreign exchange rates, and the effect on our results associated with variable accounting treatment on certain of our employee stock options.

Pro Forma Results of Operations

We provide certain pro forma information regarding our results from operations, which excludes the following line items on our statements of operations:

- stock-based compensation,
- amortization of goodwill and other intangibles, and
- restructuring-related and other charges.

We also provide certain pro forma information regarding our net loss, which excludes, in addition to the line items described above, the following line items on our statements of operations:

- other gains (losses), net;
- equity in losses of equity-method investees, net; and
- cumulative effect of change in accounting principle.

This pro forma information is not presented in accordance with accounting principles generally accepted in the United States, however, we use this pro forma measure internally to evaluate our performance and believe it may be useful. For information about our financial results, as reported in accordance with accounting principles generally accepted in the United States, see Item 6 of Part II, “Selected Consolidated Financial Data,” and Item 8 of Part II, “Financial Statements and Supplementary Data.”

Full year and corresponding quarterly pro forma results of operations, and certain cash flow information for 2001, 2000 and 1999, were as follows (in thousands):

	Year Ended December 31, 2001				
	Full Year	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Pro forma income (loss) from operations	$ (45,002)	$ 58,680	$ (27,072)	$ (28,009)	$ (48,601)
Pro forma net income (loss)	$(157,031)	$ 34,785	$ (58,005)	$ (57,528)	$ (76,283)
Pro forma income (loss) from operations as a percentage of net sales	(1%)	5%	(4%)	(4%)	(7%)
Pro forma basic income (loss) per share	$ (0.43)	$ 0.09	$ (0.16)	$ (0.16)	$ (0.21)
Pro forma diluted income (loss) per share	$ (0.43)	$ 0.09	$ (0.16)	$ (0.16)	$ (0.21)
Shares used in computation of pro forma basic income (loss) per share	364,211	371,420	368,052	359,752	357,424
Shares used in computation of pro forma diluted income (loss) per share	364,211	384,045	368,052	359,752	357,424
Net cash provided by (used in) operating activities	$(119,782)	$ 349,120	$ (64,403)	$ 2,485	$(406,984)

	Year Ended December 31, 2000				
	Full Year	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Pro forma loss from operations	$(317,000)	$ (59,946)	$ (68,439)	$ (89,349)	$ (99,266)
Pro forma net loss	$(417,158)	$ (90,426)	$ (89,493)	$(115,704)	$(121,535)
Pro forma loss from operations as a percentage of net sales	(11%)	(6%)	(11%)	(15%)	(17%)
Pro forma basic and diluted loss per share	$ (1.19)	$ (0.25)	$ (0.25)	$ (0.33)	$ (0.35)
Shares used in computation of pro forma basic and diluted loss per share	350,873	355,681	353,954	349,886	343,884
Net cash provided by (used in) operating activities	$(130,442)	$ 247,653	$ (3,688)	$ (54,029)	$(320,378)

	Year Ended December 31, 1999				
	Full Year	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Pro forma loss from operations	$(352,371)	$(175,349)	$ (79,198)	$ (67,253)	$ (30,571)
Pro forma net loss	$(389,815)	$(184,885)	$ (85,810)	$ (82,786)	$ (36,334)
Pro forma loss from operations as a percentage of net sales	(21%)	(26%)	(22%)	(21%)	(10%)
Pro forma basic and diluted loss per share	$ (1.19)	$ (0.55)	$ (0.26)	$ (0.26)	$ (0.12)
Shares used in computation of pro forma basic and diluted loss per share	326,753	338,389	332,488	322,340	313,794
Net cash provided by (used in) operating activities	$ (90,875)	$ 31,506	$ (75,573)	$ (29,614)	$ (17,194)

The following is a reconciliation of our pro forma results for 2001, 2000 and 1999. Quarterly reconciliations are consistent with full-year presentation.

	Year Ended December 31, 2001			Year Ended December 31, 2000			Year Ended December 31, 1999		
	As Reported(1)	Pro Forma Adjustments	Pro Forma	As Reported(1)	Pro Forma Adjustments	Pro Forma	As Reported(1)	Pro Forma Adjustments	Pro Forma
		(in thousands)			(in thousands)			(in thousands)	
Net sales	$3,122,433	$ —	$3,122,433	$ 2,761,983	$ —	$2,761,983	$1,639,839	—	$1,639,839
Cost of sales	2,323,875	—	2,323,875	2,106,206	—	2,106,206	1,349,194	—	1,349,194
Gross profit	798,558	—	798,558	655,777	—	655,777	290,645	—	290,645
Operating expenses:									
Fulfillment	374,250	—	374,250	414,509	—	414,509	237,312	—	237,312
Marketing	138,283	—	138,283	179,980	—	179,980	175,838	—	175,838
Technology and content	241,165	—	241,165	269,326	—	269,326	159,722	—	159,722
General and administrative	89,862	—	89,862	108,962	—	108,962	70,144	—	70,144
Stock-based compensation	4,637	(4,637)	—	24,797	(24,797)	—	30,618	(30,618)	—
Amortization of goodwill and intangibles	181,033	(181,033)	—	321,772	(321,772)	—	214,694	(214,694)	—
Restructuring-related and other	181,585	(181,585)	—	200,311	(200,311)	—	8,072	(8,072)	—
Total operating expenses	1,210,815	(367,255)	843,560	1,519,657	(546,880)	972,777	896,400	(253,384)	643,016
Loss from operations	(412,257)	367,255	(45,002)	(863,880)	546,880	(317,000)	(605,755)	253,384	(352,371)
Interest income	29,103	—	29,103	40,821	—	40,821	45,451	—	45,451
Interest expense	(139,232)	—	(139,232)	(130,921)	—	(130,921)	(84,566)	—	(84,566)
Other expense, net	(1,900)	—	(1,900)	(10,058)	—	(10,058)	1,671	—	1,671
Other gains (losses), net	(2,141)	2,141	—	(142,639)	142,639	—	—	—	—
Net interest expense and other	(114,170)	2,141	(112,029)	(242,797)	142,639	(100,158)	(37,444)	—	(37,444)
Loss before equity in losses of equity-method investees	(526,427)	369,396	(157,031)	(1,106,677)	689,519	(417,158)	(643,199)	253,384	(389,815)
Equity in losses of equity-method investees, net	(30,327)	30,327	—	(304,596)	304,596	—	(76,769)	76,769	—
Loss before cumulative effect of change in accounting principle	(556,754)	399,723	(157,031)	(1,411,273)	994,115	(417,158)	(719,968)	330,153	(389,815)
Cumulative effect of change in accounting principle	(10,523)	10,523	—	—	—	—	—	—	—
Net loss	$ (567,277)	$ 410,246	$ (157,031)	$(1,411,273)	994,115	$ (417,158)	$ (719,968)	330,153	(389,815)
Net cash used in operating activities	$ (119,782)		$ (119,782)	$ (130,442)		$ (130,442)	$ (90,875)		$ (90,875)
Basic and diluted loss per share:									
Prior to cumulative effect of change in accounting principle	$ (1.53)		$ (0.43)	$ (4.02)		$ (1.19)	$ (2.20)		$ (1.19)
Cumulative effect of change in accounting principle	(0.03)		—	—		—	—		—
	$ (1.56)		$ (0.43)	$ (4.02)		$ (1.19)	$ (2.20)		$ (1.19)
Shares used in computation of basic and diluted loss per share	364,211		364,211	350,873		350,873	326,753		326,753

(1) In accordance with accounting principles generally accepted in the United States.

We are providing pro forma results for informational purposes only. The pro forma results are derived from information recorded in our financial statements.

For the quarter ending March 31, 2002, we expect our pro forma loss from operations to be between a loss of $16 million and break-even, or between a loss of 2% to 0% of net sales. For the full year of 2002, we expect that our pro forma income from operations will be $30 million or more. However, any such projections are subject to substantial uncertainty. See Item 1 of Part I, "Business—Additional Factors That May Affect Future Results."

Liquidity and Capital Resources

Our principal source of liquidity is our cash, cash equivalents, and marketable securities. Our cash and cash equivalents balance was $540 million and $822 million, and our marketable securities balance was $456 million and $278 million at December 31, 2001 and 2000, respectively. Combined cash, cash equivalents, and marketable securities were $997 million and $1.10 billion at December 31, 2001 and 2000, respectively. Equity securities of $13 million are included in "Marketable securities" at December 31, 2001, the value of which may fluctuate significantly. Equity securities of $36 million were included in "Marketable securities" at December 31, 2000.

As of December 31, 2001, our principal commitments consisted of long-term obligations totaling $2.16 billion related primarily to our 6.875% PEACS, 4.75% Convertible Subordinated Notes and Senior Discount Notes; trade payables of $445 million; accrued expenses and other liabilities of $305 million, which includes current restructuring-related obligations of $41 million; as well as $474 million in obligations related to operating leases and commitments for advertising and promotional arrangements. We generally have payment terms with our vendors that extend beyond the amount of time necessary to collect proceeds from our customers. As a result of holiday sales, at December 31 of each year our cash, cash equivalents and marketable securities balance reaches its highest level (other than as a result of cash flows provided by investing and financing activities). This operating cycle results in a corresponding increase in accounts payable, which at December 31, 2001 was $445 million. The majority of our accounts payable balance at December 31, 2001 will be settled during the first three months of 2002 and will result in a corresponding decline in the amount of cash, cash equivalents and marketable securities on hand, offset by amounts payable associated with activity in the first quarter of 2002.

We have pledged a portion of our marketable securities as collateral for stand-by letters of credit that guarantee certain of our contractual obligations, a majority of which relates to property leases; the swap agreement that hedges the foreign-exchange rate risk on a portion of our 6.875% PEACS; and some of our real estate lease agreements. The amount of marketable securities we are required to pledge pursuant to the swap agreement fluctuates with the fair market value of the swap obligation. At December 31, 2001, the total amount of collateral pledged under these agreements was as follows (in thousands):

Stand-by letters of credit	$ 77,635
Swap agreement	48,498
Real estate leases	40,657
	$166,790

The following are our contractual commitments associated with our operational restructuring, debt obligations, lease obligations, and our marketing agreements (in thousands):

	Year Ending December 31,						
	2002	2003	2004	2005	2006	Thereafter	Total
Restructuring-related commitments:							
Leases	$ 35,578	$ 5,476	$ 2,016	$ 1,983	$ 2,068	$ 6,066	$ 53,187
Other	5,220	3,031	—	—	—	—	8,251
Restructuring-related commitments	40,798	8,507	2,016	1,983	2,068	6,066	61,438
Other Commitments:							
Debt principal and other	4,775	4,462	2,004	74	—	2,123,593	2,134,908
Debt interest	109,501	122,704	135,906	135,906	135,906	388,563	1,028,486
Capital leases	11,339	6,573	41	—	—	—	17,953
Operating leases	60,837	57,501	48,729	41,953	42,400	206,373	457,793
Marketing agreements	16,411	217	—	—	—	—	16,628
Other commitments	202,863	191,457	186,680	177,933	178,306	2,718,529	3,655,768
Total commitments	$243,661	$199,964	$188,696	$179,916	$180,374	$2,724,595	$3,717,206

Net cash used by operating activities consists of net loss offset by certain adjustments not affecting current-period cash flows, and the effect of changes in working capital. Adjustments to net income to determine cash flows from operations include depreciation and amortization, equity in losses of investees, and other items not affecting cash flows in the current period. Net cash used by operating activities during 2001 was $120 million, resulting from our net loss of $567 million, offset by adjustments not affecting 2001 cash flows of $412 million, and changes in working capital of $36 million. Net cash used by operating activities during 2000 was $130 million, resulting from our net loss of $1.41 billion, offset by adjustments not affecting 2000 cash flows of $1.10 billion, and changes in working capital of $178 million. Net cash used by operating activities during 1999 was $91 million resulting from our net loss of $720 million, offset by adjustments not affecting 1999 cash flows of $405 million, and changes in working capital of $224 million. Improvements in cash flows from operating activities and an improvement in inventory turns during 2001 were partially offset by slower revenue growth and a decline in the average number of days trade payables remain outstanding due to, among other things, a shift in revenue mix towards segments with shorter payment terms, such as U.S. Electronics, Tools and Kitchen and International.

Cash used in investing activities during 2001 was $253 million, consisting of net purchases of marketable securities of $197 million, purchases of fixed assets of $50 million and cash paid for acquired assets of $6 million. Cash provided by investing activities during 2000 was $164 million, consisting of net sales of marketable securities of $361 million offset by cash paid for investments of $63 million and purchases of fixed assets of $135 million. Cash used in investing activities during 1999 was $952 million, consisting of net purchases of marketable securities of $295 million, purchases of fixed assets of $287 million and cash paid for investments of $370 million.

Net cash provided by financing activities during 2001 was $107 million, consisting primarily of proceeds from the issuance of common stock to America Online as well as exercises of stock options, offset by repayments of long-term capital lease obligations. Net cash provided by financing activities during 2000 and 1999 was $693 million and $1.10 billion, respectively, consisting primarily of net proceeds from our issuance of debt securities. During 2000, we issued 690 million Euros of 6.875% PEACS, and during 1999 we issued $1.25 billion of 4.75% Convertible Subordinated Notes.

We believe that current cash, cash equivalents and marketable securities balances will be sufficient to meet our anticipated operating cash needs for at least the next 12 months. In addition, we expect to have positive operating cash flow, and possibly free cash flow, for fiscal year 2002. However, any projections of future cash needs and cash flows are subject to substantial uncertainty. See "Additional Factors that May Affect Future Results." We continually evaluate opportunities to sell additional equity or debt securities, obtain credit facilities from lenders, or restructure our long-term debt for strategic reasons or to further strengthen our financial position. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders. In addition, we will, from time to time, consider the acquisition of or investment in complementary businesses, products, services and technologies, and the repurchase and retirement of debt, which might affect our liquidity requirements or cause us to issue additional equity or debt securities. There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all.

Strategic Alliances

Beginning in 1999, we offered services to other e-commerce companies including permitting third parties to offer products or services on our Web site, and promotional services such as advertising placements and customer referrals. We may enter into similar transactions in the future. Beginning with our strategic alliance with Toysrus.com in 2000, we began expanding our range of services. We now offer a variety of services to third parties, including offering consumer products sold by us through Syndicated Stores; allowing third parties to utilize our technology services such as search, browse and personalization; and powering third-party Web-sites, providing fulfillment services, or both. In exchange for the services we provide under these agreements, we receive cash and/or equity securities of these companies (additional benefits may include Web site traffic). The amount of compensation we receive under certain of these agreements is dependent on the volume of sales which the other company makes. In some cases, such as our agreement with drugstore.com, we have also made separate investments in the other company by making a cash payment in exchange for equity securities of that company. As part of this program, we may in the future make additional investments in companies with which we have already formed strategic alliances or companies with which we form new strategic alliances or similar arrangements. To the extent we have received equity securities as compensation, fluctuations in the value of such securities will affect our ultimate realization of amounts we have received as compensation for services.

For equity securities of public companies, we generally determine fair value based on the quoted market price at the time we enter into the underlying commercial agreement, and adjust such market price appropriately if significant restrictions on marketability exist. Because an observable market price does not exist for equity securities of private companies, our estimates of fair value of such securities are more subjective than for the securities of public companies. For significant transactions involving equity securities in private companies, we obtain and consider independent, third-party valuations where appropriate. Such valuations use a variety of methodologies to estimate fair value, including comparing the security with securities of publicly traded companies in similar lines of business, applying price multiples to estimated future operating results for the private company, and utilizing estimated discounted cash flows for that company. These valuations also reduce the otherwise fair value by a factor that is intended to account for restrictions on control and marketability where appropriate. Using these valuations and other information available to us, such as our knowledge of the industry and knowledge of specific information about the investee, we determine the estimated fair value of the securities received.

The fair value of these securities, less the net amount of cash we paid for them, is then recorded as unearned revenue. Our recorded unearned revenue resulting from these transactions and any additional proceeds received under the arrangements is recognized as revenue over the terms (generally, one to three years) of the commercial agreements with these companies. Pursuant to EITF Issue No. 00-8, “Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services,” we do not adjust unearned revenue to give effect to either an increase or decrease in value of the equity securities subsequent to their initial measurement (to the extent that such securities are either not subject to vesting or forfeiture or, if subject to vesting or forfeiture, were not received or modified after March 16, 2000). Therefore, the value of equity securities recorded as unearned revenue could decline in value significantly after the initial measurement is made. We have in the past, and may in the future, experience losses with respect to investments in strategic companies that are not equity-method investees as a result of either liquidation of such investments at a loss or provision for an other-than-temporary decline in the fair value of these investments. See “Other gains (losses), net.” In addition, we have in the past, and may in the future, amend our agreements with certain of the companies with which we have strategic alliances to reduce future cash proceeds to be received by us, shorten the term of our commercial agreements, or both. Although these amendments did not affect the amount of unearned revenue previously recorded by us, the timing of revenue recognition of these recorded unearned amounts has been changed to correspond with the terms of the amended agreements. These amendments or future amendments will affect the timing and amount of revenues recognized in connection with these strategic alliances. To the extent we believe any such amendments cause or may cause the compensation to be received under an agreement to no longer be fixed or determinable, we limit our revenue recognition to amounts received, excluding any future amounts not deemed fixed or determinable. As future amounts are subsequently received, such amounts are incorporated into our revenue recognition over the remaining term of the agreement.

As of December 31, 2001, our recorded basis in equity securities was $41 million, including $13 million classified as "Marketable securities," $10 million classified as "Investments in equity-method investees," and $18 million classified as "Other equity investments."

During 2001 and 2000, activity in unearned revenue was as follows (in thousands):

Balance, December 31, 1999	$ 54,790
Cash received or cash receivable	97,818
Fair value of equity securities received	106,848
Amortization to revenue	(108,211)
Contract termination	(20,128)
Balance, December 31, 2000	131,117
Cash received or cash receivable	114,738
Fair value of equity securities received	331
Amortization to revenue	(135,808)
Contract termination	(22,400)
Balance, December 31, 2001	$ 87,978

During the first quarter of 2001, we recognized previously unearned revenue associated with the termination of our commercial agreement with Kozmo.com, which was included in "Other gains (losses), net" on our statements of operations. Since services had not yet been performed under the contract, no amounts associated with the Kozmo.com commercial agreement were previously recognized in "Net sales" on our statements of operations during any period.

During 2000, living.com declared bankruptcy and terminated its commercial agreement with us. As a result, we recorded a net gain of $6 million, comprised of a $14 million impairment loss representing our remaining investment balance in living.com and a $20 million gain relating to the unamortized portion of unearned revenue associated with the living.com commercial agreement as we were no longer obligated to perform services. The gain and the loss are recorded net and included in "Other gains (losses), net" on our statements of operations.

Item 7A. *Quantitative and Qualitative Disclosure About Market Risk*

We are exposed to market risk for the effect of interest rate changes, foreign currency fluctuations and changes in the market values of our investments.

Information relating to quantitative and qualitative disclosure about market risk is set forth below and in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and our long-term debt. All of our cash equivalent and marketable fixed income securities are designated as available-for-sale and, accordingly, are presented at fair value on our balance sheets. We generally invest our excess cash in A-rated or higher short- to intermediate-term fixed income securities and money market mutual funds. Fixed rate securities may have their fair market value adversely affected due to a rise in interest rates, and we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates.

The following table provides information about our cash equivalent and marketable fixed income securities, including principal cash flows by expected maturity, and the related weighted average interest rates at December 31, 2001. Amounts are as follows (in thousands, except percentages):

	2002	2003	2004	2005	2006	Thereafter	Total	Estimated Fair Value at December 31, 2001
Commercial paper and short-term obligations	$419,098	$ —	$ —	$—	$—	$ —	$419,098	$418,936
Weighted average interest rate	2.33%	—	—	—	—	—	2.33%	
Certificates of deposit	18,159	—	—	—	—	—	18,159	18,159
Weighted average interest rate	3.48%	—	—	—	—	—	3.48%	
Corporate notes and bonds	—	26,520	7,800	—	—	—	34,320	37,602
Weighted average interest rate	—	2.98%	4.00%	—	—	—	3.21%	
Asset-backed and agency securities	6,209	73,070	149,765	—	—	1,767	230,811	232,821
Weighted average interest rate	2.55%	3.42%	3.63%	—	—	7.64%	3.56%	
Treasury notes and bonds	11,900	72,100	36,700	—	—	—	120,700	125,947
Weighted average interest rate	2.05%	2.44%	3.42%	—	—	—	2.70%	
Cash equivalents and marketable fixed-income securities	$455,366	$171,690	$194,265	$—	$—	$1,767	$823,088	$833,465

The following table provides information about our cash equivalent and marketable fixed income securities, including principal cash flows by expected maturity, and weighted average interest rates at December 31, 2000. Amounts were as follows (in thousands, except percentages):

	2001	2002	2003	2004	2005	Thereafter	Total	Estimated Fair Value at December 31, 2000
Commercial paper and short-term obligations	$677,895	$ —	$ —	$—	$ —	$ —	$677,895	$677,895
Weighted average interest rate	5.40%	—	—	—	—	—	5.40%	
Corporate notes and bonds	950	7,937	8,560	—	—	—	17,447	17,447
Weighted average interest rate	4.45%	4.95%	4.95%	—	—	—	4.92%	
Asset-backed and agency securities	21,507	11,718	11,114	—	19,635	20,747	84,721	85,189
Weighted average interest rate	5.68%	5.96%	4.71%	—	6.87%	7.39%	6.30%	
Treasury notes and bonds	42,535	74,021	25,595	—	—	—	142,151	142,085
Weighted average interest rate	5.05%	5.22%	4.52%	—	—	—	5.04%	
Cash equivalents and marketable fixed-income securities	$742,887	$93,676	$45,269	$—	$19,635	$20,747	$922,214	$922,616

At December 31, 2001, we have long-term debt of $2.16 billion primarily associated with our 6.875% PEACS, 4.75% Convertible Subordinated Notes and Senior Discount Notes, which are due in 2010, 2009 and 2008, respectively. Our payment commitments associated with these debt instruments are fixed during the corresponding terms and are comprised of interest payments, principal payments, or a combination thereof. The market value of our long-term debt will fluctuate with movements of interest rates, increasing in periods of declining rates of interest, and declining in periods of increasing rates of interest.

Foreign Currency Exchange Rate Risk

During 2001, net sales from our internationally-focused Web sites (*www.amazon.co.uk, www.amazon.de, www.amazon.fr,* and *www.amazon.co.jp*) accounted for 21% of consolidated revenues. Net sales generated from these Web sites, as well as most of the related expenses incurred, are denominated in the functional currencies of the corresponding Web sites. The functional currency of our subsidiaries that either operate or support *www.amazon.co.uk, www.amazon.de, www.amazon.fr,* and *www.amazon.co.jp* is the same as the local currency of the United Kingdom, Germany, France and Japan, respectively. Results of operations from our foreign subsidiaries and our subsidiaries that operate our internationally-focused Web sites are exposed to foreign currency exchange rate fluctuations as the financial results of these subsidiaries are translated into U.S. dollars upon consolidation. As exchange rates vary, net sales and other operating results, when translated, may differ materially from expectations. The effect of foreign currency exchange rate fluctuations on the results of operations of our internationally-focused Web sites for 2001 was not material.

At December 31, 2001, we were also exposed to foreign currency risk related to our 6.875% PEACS and Euro-denominated cash equivalents and marketable securities ("Euro Investments"). The 6.875% PEACS have an outstanding principal balance of 690 million Euros ($609 million, based on the exchange rate as of December 31, 2001), and our Euro Investments, classified as available-for-sale, had a balance of 179 million Euros ($158 million, based on the exchange rate as of December 31, 2001). As the Euro/U.S. dollar exchange ratio varies, the value of our Euro Investments, when translated, will fluctuate. Debt principal of 615 million Euros is remeasured each period, which results in currency gains or losses that are recorded in "Other gains (losses), net" on our statements of operations. We hedge the exchange rate risk on debt principal of 75 million Euros and a portion of the interest payments using a cross-currency swap agreement. Under the swap agreement, we agreed to pay at inception and receive upon maturity 75 million Euros in exchange for receiving at inception and paying at maturity $67 million. In addition, we agreed to receive in February of each year 27 million Euros corresponding with interest payments on 390 million Euros of the 6.875% PEACS and, simultaneously, to pay $32 million. This agreement is cancelable, in whole or in part, at our option at no cost on or after February 20, 2003 if our common stock price (converted into Euros) is greater than or equal to 84.883 Euros, the minimum conversion price of the 6.875% PEACS. We account for the swap agreement as a cash flow hedge of the risk of exchange rate fluctuations on the debt principal and interest. Gains and losses on the swap agreement are initially recorded in "Accumulated other comprehensive loss" on our balance sheets and recognized in "Other gains (losses), net" on our statements of operations upon the recognition of the corresponding currency losses and gains on the remeasurement of the 6.875% PEACS.

Investment Risk

As of December 31, 2001, our recorded basis in equity securities was $41 million, including $13 million classified as "Marketable securities," $10 million classified as "Investments in equity-method investees," and $18 million classified as "Other equity investments." We invest in the stock and/or warrants of both private and public companies, including companies with which we have formed strategic alliances, primarily for strategic purposes. At December 31, 2001, our investments in securities of publicly-held companies was $16 million, and our investments in securities of privately-held companies was $25 million. We have also received securities, including warrant investments, from some of the companies with which we have formed strategic alliances in exchange for services provided by us to those companies. Our investments are accounted for under the equity method if we have the ability to exercise significant influence, but not control, over an investee. Some of our cost-method investments are in private companies and are accounted for at cost and others are in public companies and are accounted for as available-for-sale securities and recorded at fair value. Warrant investments are generally carried at fair value. We regularly review the carrying value of our investments and identify and record losses when events and circumstances indicate that such declines in the fair value of such assets below our accounting basis are other-than-temporary. During 2001, we recorded impairment losses totaling $44 million to write-down several of our equity securities to fair value. All of these investments are in companies involved in the Internet and e-commerce industries and their fair values are subject to significant fluctuations due to volatility of the stock market and changes in general economic conditions. Based on the fair value of the publicly-traded equity securities we held at December 31, 2001, an assumed 15%, 30% or 50% adverse change to market prices of these securities would result in a corresponding decline in total fair value of approximately $6 million, $12 million or $21 million, respectively.

Item 8. ***Financial Statements and Supplementary Data***

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Amazon.com, Inc.

We have audited the accompanying consolidated balance sheets of Amazon.com, Inc. as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2001. Our audits also included the financial statement schedule listed at Item 14(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Amazon.com, Inc. at December 31, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, effective January 1, 2001.

/s/ Ernst & Young LLP

Seattle, Washington
January 18, 2002

AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	December 31, 2001	December 31, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	$ 540,282	$ 822,435
Marketable securities	456,303	278,087
Inventories	143,722	174,563
Prepaid expenses and other current assets	67,613	86,044
Total current assets	1,207,920	1,361,129
Fixed assets, net	271,751	366,416
Goodwill, net	45,367	158,990
Other intangibles, net	34,382	96,335
Investments in equity-method investees	10,387	52,073
Other equity investments	17,972	40,177
Other assets	49,768	60,049
Total assets	$ 1,637,547	$ 2,135,169
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 444,748	$ 485,383
Accrued expenses and other current liabilities	305,064	272,683
Unearned revenue	87,978	131,117
Interest payable	68,632	69,196
Current portion of long-term debt and other	14,992	16,577
Total current liabilities	921,414	974,956
Long-term debt and other	2,156,133	2,127,464
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, $0.01 par value:		
Authorized shares—500,000		
Issued and outstanding shares—none	—	—
Common stock, $0.01 par value:		
Authorized shares—5,000,000		
Issued and outstanding shares—373,218 and 357,140 shares, respectively	3,732	3,571
Additional paid-in capital	1,462,769	1,338,303
Deferred stock-based compensation	(9,853)	(13,448)
Accumulated other comprehensive loss	(36,070)	(2,376)
Accumulated deficit	(2,860,578)	(2,293,301)
Total stockholders' deficit	(1,440,000)	(967,251)
Total liabilities and stockholders' deficit	$ 1,637,547	$ 2,135,169

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.

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

	Years Ended December 31,		
	2001	2000	1999
Net sales	$3,122,433	$ 2,761,983	$1,639,839
Cost of sales	2,323,875	2,106,206	1,349,194
Gross profit	798,558	655,777	290,645
Operating expenses:			
Fulfillment	374,250	414,509	237,312
Marketing	138,283	179,980	175,838
Technology and content	241,165	269,326	159,722
General and administrative	89,862	108,962	70,144
Stock-based compensation	4,637	24,797	30,618
Amortization of goodwill and other intangibles	181,033	321,772	214,694
Restructuring-related and other	181,585	200,311	8,072
Total operating expenses	1,210,815	1,519,657	896,400
Loss from operations	(412,257)	(863,880)	(605,755)
Interest income	29,103	40,821	45,451
Interest expense	(139,232)	(130,921)	(84,566)
Other income (expense), net	(1,900)	(10,058)	1,671
Other gains (losses), net	(2,141)	(142,639)	—
Net interest expense and other	(114,170)	(242,797)	(37,444)
Loss before equity in losses of equity-method investees	(526,427)	(1,106,677)	(643,199)
Equity in losses of equity-method investees, net	(30,327)	(304,596)	(76,769)
Loss before change in accounting principle	$ (556,754)	$(1,411,273)	$ (719,968)
Cumulative effect of change in accounting principle	(10,523)	—	—
Net loss	$ (567,277)	$(1,411,273)	$ (719,968)
Basic and diluted loss per share:			
Prior to cumulative effect of change in accounting principle	$ (1.53)	$ (4.02)	$ (2.20)
Cumulative effect of change in accounting principle	(0.03)	—	—
	$ (1.56)	$ (4.02)	$ (2.20)
Shares used in computation of basic and diluted loss per share	364,211	350,873	326,753

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31,		
	2001	2000	1999
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 822,435	$ 133,309	$ 71,583
OPERATING ACTIVITIES:			
Net loss	(567,277)	(1,411,273)	(719,968)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation of fixed assets and other amortization	84,709	84,460	36,806
Stock-based compensation	4,637	24,797	30,618
Equity in losses of equity-method investees, net	30,327	304,596	76,769
Amortization of goodwill and other intangibles	181,033	321,772	214,694
Non-cash restructuring-related and other	73,293	200,311	8,072
Loss (gain) on sale of marketable securities, net	(1,335)	(280)	8,688
Other losses (gains), net	2,141	142,639	—
Non-cash interest expense and other	26,629	24,766	29,171
Cumulative effect of change in accounting principle	10,523	—	—
Changes in operating assets and liabilities:			
Inventories	30,628	46,083	(172,069)
Prepaid expenses and other current assets	20,732	(8,585)	(54,927)
Accounts payable	(44,438)	22,357	330,166
Accrued expenses and other current liabilities	50,031	93,967	95,839
Unearned revenue	114,738	97,818	6,225
Amortization of previously unearned revenue	(135,808)	(108,211)	(5,837)
Interest payable	(345)	34,341	24,878
Net cash used in operating activities	(119,782)	(130,442)	(90,875)
INVESTING ACTIVITIES:			
Sales and maturities of marketable securities	370,377	545,724	2,064,101
Purchases of marketable securities	(567,152)	(184,455)	(2,359,398)
Purchases of fixed assets, including internal use software and web-site development	(50,321)	(134,758)	(287,055)
Investments in equity-method investees and other investments	(6,198)	(62,533)	(369,607)
Net cash provided by (used in) investing activities	(253,294)	163,978	(951,959)
FINANCING ACTIVITIES:			
Proceeds from exercise of stock options and other	16,625	44,697	64,469
Proceeds from issuance of common stock, net of issuance costs	99,831	—	—
Proceeds from long-term debt and other	10,000	681,499	1,263,639
Repayment of long-term debt and other	(19,575)	(16,927)	(188,886)
Financing costs	—	(16,122)	(35,151)
Net cash provided by financing activities	106,881	693,147	1,104,071
Effect of exchange-rate changes on cash and cash equivalents	(15,958)	(37,557)	489
Net increase (decrease) in cash and cash equivalents	(282,153)	689,126	61,726
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 540,282	$ 822,435	$ 133,309
SUPPLEMENTAL CASH FLOW INFORMATION:			
Fixed assets acquired under capital leases	$ 4,597	$ 4,459	$ 25,850
Fixed assets acquired under financing agreements	1,000	4,844	5,608
Equity securities received for commercial agreements	331	106,848	54,402
Stock issued in connection with business acquisitions and minority investments	5,000	32,130	774,409
Cash paid for interest	112,184	67,252	30,526

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(in thousands)

	Common Stock Shares	Amount	Additional Paid-In Capital	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance at December 31, 1998	318,534	$3,186	$ 297,438	$ (1,625)	$ 1,806	$ (162,060)	$ 138,745
Net loss	—	—	—	—	—	(719,968)	(719,968)
Foreign currency translation gains	—	—	—	—	490	—	490
Change in unrealized gain (loss) on available-for-sale securities, net	—	—	—	—	(4,005)	—	(4,005)
Comprehensive loss	—	—	—	—	—	—	(723,483)
Issuance of capital stock, net of issuance costs	10,496	105	743,169	—	—	—	743,274
Exercise of common stock options, net	16,125	161	67,969	—	—	—	68,130
Public offering of equity-method investee	—	—	13,787	—	—	—	13,787
Note receivable for common stock	—	—	(72)	—	—	—	(72)
Deferred stock-based compensation, net of adjustments	—	—	72,078	(72,078)	—	—	—
Amortization of deferred stock-based compensation	—	—	—	25,897	—	—	25,897
Balance at December 31, 1999	345,155	3,452	1,194,369	(47,806)	(1,709)	(882,028)	266,278
Net loss	—	—	—	—	—	(1,411,273)	(1,411,273)
Foreign currency translation losses	—	—	—	—	(364)	—	(364)
Change in unrealized gain (loss) on available-for-sale securities, net	—	—	—	—	(303)	—	(303)
Comprehensive loss	—	—	—	—	—	—	(1,411,940)
Issuance of capital stock, net of issuance costs	866	8	30,977	—	—	—	30,985
Exercise of common stock options, net	11,119	111	41,995	—	—	—	42,106
Public offering of equity-method investee	—	—	76,898	—	—	—	76,898
Note receivable for common stock	—	—	27	—	—	—	27
Deferred stock-based compensation, net of adjustments	—	—	(5,963)	2,528	—	—	(3,435)
Amortization of deferred stock-based compensation	—	—	—	31,830	—	—	31,830
Balance at December 31, 2000	357,140	3,571	1,338,303	(13,448)	(2,376)	(2,293,301)	(967,251)
Net loss	—	—	—	—	—	(567,277)	(567,277)
Foreign currency translation losses	—	—	—	—	(1,257)	—	(1,257)
Change in unrealized gain (loss) on available-for-sale securities, net	—	—	—	—	7,005	—	7,005
Net Unrealized losses on Euro-based currency swap	—	—	—	—	(17,337)	—	(17,337)
Reclassification of currency gains on 6.875% PEACS	—	—	—	—	(9,811)	—	(9,811)
Cumulative effect of change in accounting principle	—	—	—	—	(12,294)	—	(12,294)
Comprehensive loss	—	—	—	—	—	—	(600,971)
Issuance of capital stock, net of issuance costs	8,989	90	98,716	—	—	—	98,806
Exercise of common stock options, net	6,089	61	14,989	—	—	—	15,050
Repayments of note receivable for common stock	—	—	1,130	—	—	—	1,130
Deferred stock-based compensation, net of adjustments	1,000	10	9,631	(4,797)	—	—	4,844
Amortization of deferred stock-based compensation	—	—	—	8,392	—	—	8,392
Balance at December 31, 2001	373,218	$3,732	$1,462,769	$ (9,853)	$(36,070)	$(2,860,578)	$(1,440,000)

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—DESCRIPTION OF BUSINESS AND ACCOUNTING POLICIES

Description of Business

Amazon.com, Inc. commenced operations on the World Wide Web in July 1995. The Company sells products worldwide, with its principal geographies in North America, Europe and Asia. The Company and its sellers list millions of unique items in categories such as books, music, DVDs, videos, electronics, computers, camera and photo items, software, computer and video games, cell phones and service, tools and hardware, outdoor living items, kitchen and houseware products, toys, baby and baby registry, travel services and magazine subscriptions. Through its Amazon Marketplace, Auctions and zShops services, businesses and individuals can sell virtually any product to Amazon.com's customer base, and with Amazon.com Payments, sellers are able to accept credit card transactions in addition to other methods of payment. The Company operates a U.S.-based Web site, *www.amazon.com*, and four internationally-focused Web sites: *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr* and *www.amazon.co.jp*.

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used for, but not limited to, inventory allowances, depreciation, amortization, sales returns, the accounting for doubtful accounts, unearned revenue, sub-lease income offsetting lease commitments, valuation of investments, taxes and contingencies. Actual results could differ from those estimates.

Business Combinations

For business combinations that have been accounted for under the purchase method of accounting, the Company includes the results of operations of the acquired business from the date of acquisition. Net assets of the companies acquired are recorded at their fair value at the date of acquisition. The excess of the purchase price over the fair value of tangible and identifiable intangible net assets acquired is included in goodwill on the accompanying consolidated balance sheets.

Effective July 1, 2001, pooling-of-interest accounting is no longer allowed under accounting principles generally accepted in the United States. No business combinations were accounted for under this method during 2001, 2000 or 1999.

Cash and Cash Equivalents

The Company classifies all highly liquid instruments with an original maturity of three months or less at the time of purchase as cash equivalents.

Inventories

Inventories, consisting of products available for sale, are recorded using the specific-identification method and valued at the lower of cost or market value.

Fixed Assets

Fixed assets are stated at cost less accumulated depreciation, which includes the amortization of assets recorded under capital leases. Fixed assets, including assets purchased under capital leases, are depreciated on a straight-line basis over the estimated useful lives of the assets (generally two to ten years).

Included in fixed assets is the cost of internal-use software, including software used to develop and operate the Company's Web sites. The Company expenses all costs related to the development of internal-use software other than those incurred during the application development stage. Costs incurred during the application development stage are capitalized and amortized over the estimated useful life of the software (generally two years).

Goodwill and Other Intangibles

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business acquisitions accounted for under the purchase accounting method. Other intangibles include identifiable intangible assets purchased by the Company, primarily in connection with business acquisitions. Goodwill and other intangibles are presented net of related accumulated amortization and impairment charges and are being amortized over lives ranging from two to four years. Acquisitions subsequent to June 30, 2001 resulting in goodwill and indefinite-lived intangibles are accounted for under a non-amortization approach and are evaluated periodically for impairment.

The Company records impairment losses on goodwill and other intangible assets when events and circumstances indicate that such assets might be impaired and the estimated fair value of the asset is less than its recorded amount. Conditions that would necessitate an impairment assessment include material adverse changes in operations, significant adverse differences in actual results in comparison with initial valuation forecasts prepared at the time of acquisition, a decision to abandon acquired products, services or technologies, or other significant adverse changes that would indicate the carrying amount of the recorded asset might not be recoverable.

Goodwill is viewed in two separate categories: enterprise-level and business-unit level. Enterprise-level goodwill results from purchase acquisitions of businesses that have been fully integrated into the Company's operations and no longer exist as a discrete business unit. Business-unit goodwill results from purchase business combinations where the acquired operations have been managed as a separate business unit and not fully absorbed into the Company. Enterprise-level goodwill is evaluated using the market-value method, which compares the Company's net book value to the value indicated by the market price of the Company's equity securities; if the net book value were to exceed the Company's market capitalization, the excess carrying amount of goodwill would be written off as an impairment-related charge. Measurement of fair value for business-unit goodwill as well as other intangibles is based on discounted cash flow analysis at the business-unit level.

Investments

The Company has certain investments in debt and equity securities.

Investments are accounted for using the equity method of accounting if the investment gives the Company the ability to exercise significant influence, but not control, over an investee. Significant influence is generally deemed to exist if the Company has an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's Board of Directors and the effect of commercial arrangements, are considered in determining whether the equity method of accounting is appropriate. The Company records its equity in the income or losses of these investees generally one month in arrears for private companies and three months in arrears for public companies. The Company records its investments in equity-method investees on the consolidated balance sheets as “Investments in equity-method investees” and its share of the investees’ earnings or losses as “Equity in losses of equity-method investees, net” on the consolidated statements of operations.

All other equity investments, which consist of investments for which the Company does not have the ability to exercise significant influence, are accounted for under the cost method. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value, distributions of earnings and additional investments. For public companies that have readily determinable fair values, the Company classifies its equity investments as available-for-sale and, accordingly, records these investments at their fair values with unrealized gains and losses included in “Accumulated other comprehensive loss.” Such investments are included in “Marketable securities” on the accompanying consolidated balance sheets if the Company does not have the intent to hold the investment for over one year from the balance sheet date. In cases where the Company does not have the intent and ability to liquidate such investments within one year from the balance sheet date such investments are included in “Other equity investments.”

The Company also invests in certain marketable debt securities, which consist primarily of high-quality short- to intermediate-term fixed income securities that are also classified as available-for-sale securities. Such investments are included in “Marketable securities” on the accompanying consolidated balance sheets and are reported at fair value with unrealized gains and losses included in “Accumulated other comprehensive loss.” The weighted average method is used to determine the cost of Euro-denominated securities sold, and the specific identification method is used to determine the cost of all other securities.

The initial cost of the Company’s investments is determined based on the fair value of the investment at the time of its acquisition. The Company has received equity securities as consideration for services to be performed for the issuer under commercial agreements. In such cases, the Company has estimated the fair value of the equity securities received. For securities of public companies, the Company generally determines fair value based on the quoted market price at the time the Company enters into the underlying agreement, and adjusts such market price appropriately if significant restrictions on marketability exist. As an observable market price does not exist for equity securities of private companies, estimates of fair value of such securities are more subjective than for securities of public companies. For significant transactions involving equity securities in private companies, the Company obtains and considers independent, third party valuations where appropriate. Such valuations use a variety of methodologies to estimate fair value, including comparing the security with securities of publicly traded companies in similar lines of business, applying price multiples to estimated future operating results for the private company, and estimating discounted cash flows for that company. These valuations also reduce the fair value to account for restrictions on control and marketability where appropriate. Using these valuations and other information available to the Company, such as the Company’s knowledge of the industry and knowledge of specific information about the investee, the Company determines the estimated fair value of the securities received. To the extent that equity securities received or modified after March 16, 2000 are subject to forfeiture or vesting provisions and no significant performance commitment exists upon signing of the agreements, the fair value of the securities is determined as of the date of the respective forfeiture or as vesting provisions lapse.

The Company periodically evaluates whether the declines in fair value of its investments are other-than-temporary. This evaluation consists of a review of qualitative and quantitative factors by members of senior management. For investments with publicly quoted market prices, the Company generally considers a decline to be an other-than-temporary impairment if the quoted market price is less than its accounting basis for two consecutive quarters, absent evidence to the contrary. The Company considers additional factors to determine whether declines in fair value are other-than-temporary, such as the investee's financial condition, results of operations, operating trends and other financial ratios. The evaluation also considers publicly available information regarding the investee companies, including reports from investment analysts and other publicly available investee-specific news or general market conditions. For investments in private companies with no quoted market price, the Company considers similar qualitative and quantitative factors and also considers the implied value from any recent rounds of financing completed by the investee, as well as market prices of comparable public companies. The Company generally requires its private investees to deliver monthly, quarterly and annual financial statements to assist in reviewing relevant financial data and to assist in determining whether such data may indicate other-than-temporary declines in fair value below the Company's accounting basis.

Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. The Company does not perform a periodic assessment of assets for impairment in the absence of such information or indicators. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or a significant adverse change that would indicate that the carrying amount of an asset or group of assets is not recoverable. For long-lived assets to be held and used, the Company measures fair value based on quoted market prices or based on discounted estimates of future cash flows. Long-lived assets to be disposed of are carried at fair value less costs to sell.

Unearned Revenue

Unearned revenue is recorded when payments, whether received in cash or equity securities, are received in advance of the Company's performance in the underlying agreement. Unearned revenue is amortized ratably over the period in which services are provided.

In instances where the Company receives equity securities as compensation for services to be provided under commercial arrangements, the fair value of these securities, less the net amount of cash paid for them, is then recorded as unearned revenue. Pursuant to Emerging Issues Task Force Issue No. 00-8, "Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services," the Company does not adjust unearned revenue to give effect to either increase or decrease in value of the equity securities subsequent to their initial measurement (to the extent that such securities are either not subject to vesting or forfeiture or, if subject to vesting or forfeiture, were not received or modified after March 16, 2000).

Income Taxes

The Company recognizes deferred tax assets and liabilities based on differences between the financial reporting and tax bases of assets and liabilities using the enacted tax rates and laws that are expected to be in effect when the differences are expected to be recovered. The Company provides a valuation allowance for deferred tax assets for which it does not consider realization of such assets to be more likely than not.

Revenue Recognition

The Company generally recognizes revenue from product sales or services rendered when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility is reasonably assured.

The Company evaluates the criteria outlined in EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. Generally, when the Company is the primary obligor in a transaction, is subject to inventory risk, has latitude in establishing prices and selecting suppliers, or has several but not all of these indicators, revenue is recorded gross as a principal. If the Company is not the primary obligor and amounts earned are determined using a fixed percentage, a fixed-payment schedule, or a combination of the two, the Company generally records the net amounts as commissions earned.

Product sales (including sales of products through the Company's Syndicates Stores program), net of promotional gift certificates and return allowances, are recorded when the products are shipped and title passes to customers. Return allowances are estimated using historical experience.

Commissions received on sales of products from Amazon Marketplace, Auctions and zShops are recorded as a net amount since the Company is acting as an agent in such transactions. Amounts earned are recognized as net sales when the item is sold by the third-party seller and our collectibility is reasonably assured. The Company records an allowance for refunds on such commissions using historical experience.

The Company earns revenues from services, primarily by entering into business-to-business strategic alliances, including providing the Company's technology services such as search, browse and personalization; permitting third parties to offer products or services through the Company's Web sites; and powering third-party Web sites, providing fulfillment services, or both. These strategic alliances also include miscellaneous marketing and promotional agreements. As compensation for the services the Company provides under these agreements, it receives one or a combination of cash and equity securities. If the Company receives non-refundable, up-front payments, such amounts are deferred until service commences, and are then recognized on a straight-line basis over the estimated corresponding service period. Generally, the fair value of consideration received, whether in cash, equity securities, or a combination thereof, is measured when agreement is reached, and any subsequent appreciation or decline in the fair value of the securities received does not affect the amount of revenue recognized over the term of the agreement. To the extent that equity securities received or modified after March 16, 2000 are subject to forfeiture or vesting provisions and no significant performance commitment exists upon signing of the agreements, the fair value of the securities and corresponding revenue is determined as of the date of the respective forfeiture or as vesting provisions lapse. The Company generally recognizes revenue from these services on a straight-line basis over the period during which the Company performs services under these agreements, commencing at the launch date of the service.

Outbound shipping charges to customers are included in net sales and amounted to $357 million, $339 million and $239 million in 2001, 2000 and 1999, respectively.

Cost of Sales

Cost of sales consists of the purchase price of consumer products sold by the Company, inbound and outbound shipping charges, packaging supplies, and certain costs associated with service revenues. Costs associated with service revenues classified as cost of services generally include direct and allocated indirect fulfillment-related costs to ship products on behalf of third-party sellers, costs to provide customer service, credit card fees and other related costs.

Outbound shipping charges and the cost of tangible supplies used to package products for shipment to customers totaled $376 million, $340 million, and $227 million in 2001, 2000 and 1999, respectively.

Fulfillment

Fulfillment costs represent those costs incurred in operating and staffing the Company's fulfillment and customer service centers, including costs attributable to receiving, inspecting and warehousing inventories; picking, packaging and preparing customers' orders for shipment; credit card fees and bad debt costs; variable costs from co-sourcing arrangements; and responding to inquiries from customers.

Marketing

Marketing expenses consist of advertising, promotional and public relations expenditures, and payroll and related expenses for personnel engaged in marketing and selling activities. The Company expenses general media advertising costs as incurred. The Company enters into certain on-line promotional agreements with third parties to increase traffic to its Web sites. Costs associated with these promotional agreement consist of fixed payments, variable activity-based payments, or a combination of the two. Fixed payments are amortized ratably over the corresponding agreement term, and variable payments are expensed in the period incurred. The Company receives reimbursements from vendors for certain general media and other advertising costs. Such reimbursements are classified as a contra-marketing expense. Advertising expense and other promotional costs were $125 million, $172 million and $166 million in 2001, 2000 and 1999, respectively. Prepaid advertising costs were $2 million and $6 million at December 31, 2001 and 2000, respectively.

Technology and Content

Technology and content expenses consist principally of payroll and related expenses for development, editorial, systems and telecommunications operations personnel and consultants; systems and telecommunications infrastructure; and costs of acquired content, including freelance reviews.

Technology and content costs are expensed as incurred, except for certain costs relating to the development of internal-use software, including those relating to operating the Company's Web sites, that are capitalized and depreciated over two years. For the years ended December 31, 2001, 2000 and 1999, capitalized costs related to the development of internal-use software, including those relating to operating the Company's Web sites, net of amortization, were $24 million, $21 million and $7 million, respectively.

Stock-Based Compensation

Stock-based compensation includes stock-based charges resulting from variable accounting treatment of certain options, and option-related deferred compensation recorded at the Company's initial public offering, as well as certain other compensation and severance arrangements. Stock-based compensation also includes the portion of acquisition-related consideration conditioned on the continued tenure of key employees of certain acquired businesses, which must be classified as compensation expense rather than as a component of purchase price under accounting principles generally accepted in the United States.

During the first quarter of 2001, the Company offered a limited non-compulsory exchange of employee stock options that resulted in variable accounting treatment for, at the time of the exchange, approximately 15 million stock options, which includes options granted under the exchange offer and 3 million options, with a weighted average exercise price of $52.41, that were subject to the exchange offer but were not exchanged. Variable accounting will continue until all options subject to variable accounting treatment are exercised, cancelled or expired.

For employee stock awards not subject to variable accounting, the Company recognizes expense based on the intrinsic value of the stock awards granted. Generally, expense is not recorded to the extent individual stock award exercise prices are set equal to or greater than the current market price of the Company's stock on the date of grant.

Foreign Currency

The Company has the following internationally-focused Web sites: *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr* and *www.amazon.co.jp*. Net sales generated from these Web sites, as well as most of the related expenses incurred, are denominated in the functional currencies of the Web sites. Additionally, the functional currency of the Company's subsidiaries that either operate or support *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr* and *www.amazon.co.jp* is the same as the local currency of the United Kingdom, Germany, France and Japan, respectively. Assets and liabilities of these subsidiaries are translated into U.S. dollars at year-end exchange rates, and revenues and expenses are translated at average rates prevailing during the year. Translation adjustments are included in "Accumulated other comprehensive loss," a separate component of stockholders' deficit. Transaction gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved, which have been insignificant, are included in "Other income (expense), net" on the consolidated statements of operations.

Derivative Financial Instruments

Effective January 1, 2001, the Company adopted the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) "Accounting for Derivative Instruments and Hedging Activities," (SFAS No. 133), which requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current results of operations or other comprehensive income (loss) depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. For a derivative designated as a fair value hedge, the gain or loss of the derivative in the period of change and the offsetting loss or gain of the hedged item attributed to the hedged risk are recognized in results of operations. For a derivative designated as a cash flow hedge, the effective portion of the derivative's gain or loss is initially reported as a component of other comprehensive income (loss) and subsequently reclassified into results of operations when the hedged exposure affects results of operations. The ineffective portion of the gain or loss of a cash flow hedge is recognized currently in results of operations. For a derivative not designated as a hedging instrument, the gain or loss is recognized currently in results of operations.

The Company is exposed to the risk of fluctuations in foreign exchange rates between the U.S. dollar and the Euro associated with its 6.875% PEACS (Note 7). To minimize a portion of the risk from this exposure the Company has designated swap and forward agreements as cash flow hedges of a portion of the 6.875% PEACS principal and interest based upon the criteria established by SFAS No. 133. The terms of the hedge instruments have been structured to match the related terms of the hedged portion of the 6.875% PEACS. No net gains or losses, resulting from hedge ineffectiveness, were recognized in results of operations during the year ended December 31, 2001.

The Company holds strategic investments in warrants to purchase equity securities of other companies. Warrants that can be exercised and settled by delivery of net shares such that the Company pays no cash upon exercise ("net share warrants") are deemed derivative financial instruments. Net share warrants are not designated as hedging instruments; accordingly, gains or losses resulting from changes in fair value are recognized on the consolidated statements of operations, "Other gains (losses), net," in the period of change. The Company determines the fair value of its warrants through option-pricing models using current market price and volatility assumptions, including public-company market comparables for its private-company warrants.

The adoption of SFAS No. 133 on January 1, 2001 resulted in cumulative transition losses of $11 million included in the results of operations and a stockholders' deficit adjustment of $12 million. Transition losses included in "Cumulative effect of change in accounting principle" are attributable to approximately $3 million in losses reclassified from "Accumulated other comprehensive loss" on warrants previously reported at fair value and classified as available-for-sale, and approximately $8 million in losses on warrants previously reported at cost. No warrant investments are designated as hedging instruments. Transition losses in "Accumulated other comprehensive loss" are attributable to approximately $15 million in losses on the swap agreement designated as a cash flow hedge of a portion of the 6.875% PEACS offset by the approximately $3 million in losses reclassified to results of operations on derivative instruments not designated as hedging instruments.

Effective January 1, 2001, currency gains and losses arising from the remeasurement of the 6.875% PEACS' principal from Euros to U.S. dollars each period are recorded to "Other gains (losses), net." Prior to

January 1, 2001, 6.875% PEACS' principal of 615 million Euros was designated as a hedge of an equivalent amount of Euro-denominated investments classified as available-for-sale; accordingly, currency gains and losses on the 6.875% PEACS were recorded to "Accumulated other comprehensive loss" on the consolidated balance sheets as hedging offsets to currency gains and losses on the Euro-denominated investments. As the hedge does not qualify for hedge accounting under the provisions of SFAS No. 133, commencing January 1, 2001, the foreign currency change resulting from the portion of the 6.875% PEACS previously hedging the available-for-sale securities is now being recorded to "Other gains (losses), net" on the consolidated statements of operations.

Earnings per Share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the period, net of shares subject to repurchase, and excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is computed using the weighted average number of common and common stock equivalent shares outstanding during the period; common stock equivalent shares are excluded from the computation if their effect is antidilutive.

Recent Accounting Pronouncements

In July 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against this new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles is more than its fair value. The provisions of each statement that apply to goodwill and intangible assets acquired prior to June 30, 2001 will be adopted by the Company on January 1, 2002. The Company is in the process of evaluating the financial statement effect of the adoption of these standards and expects it will result in approximately $25 million of other intangibles being subsumed into goodwill and will have the effect of substantially reducing its amortization of goodwill and intangibles commencing January 1, 2002. Transitional impairments, if any, are not expected to be material, however, impairment reviews may result in future periodic write-downs.

The FASB also recently issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," that is applicable to financial statements issued for fiscal years beginning after December 15, 2001. The FASB's new rules on asset impairment supersede SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and portions of Accounting Principles Bulletin Opinion 30, "Reporting the Results of Operations." This Standard provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction since such assets are not depreciated and are stated at the lower of fair value and carrying amount. This Standard also requires expected future operating losses from discontinued operations to be displayed in the period(s) in which the losses are incurred, rather than as of the measurement date as presently required. The provisions of this Standard are not expected to have a significant effect on the Company's financial position or operating results.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Note 2—CASH AND MARKETABLE SECURITIES

The following tables summarize, by major security type, the Company's cash and marketable securities:

Cash and Cash Equivalents

	December 31, 2001			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash	$149,968	$—	$ —	$149,968
Commercial paper and short-term obligations	394,613	—	(4,299)	390,314
	$544,581	$—	$(4,299)	$540,282

	December 31, 2000			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash	$141,922	$—	$ —	$141,922
Commercial paper and short-term obligations	696,545	87	(18,737)	677,895
Asset-backed and agency securities	2,618	—	—	2,618
	$841,085	$ 87	$(18,737)	$822,435

Marketable Securities

	December 31, 2001			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Certificates of deposit	$ 18,692	$ —	$(533)	$ 18,159
Commercial paper and short-term obligations	28,614	8	—	28,622
Corporate notes and bonds	37,370	240	(8)	37,602
Asset-backed and agency securities	231,912	909	—	232,821
Treasury notes and bonds	125,687	260	—	125,947
Equity securities	12,395	832	(75)	13,152
	$454,670	$2,249	$(616)	$456,303

	December 31, 2000			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Corporate notes and bonds	$ 16,063	$ 1,384	$ —	$ 17,447
Asset-backed and agency securities	80,748	1,982	(159)	82,571
Treasury notes and bonds	134,646	7,647	(208)	142,085
Equity securities	37,434	—	(1,450)	35,984
	$268,891	$11,013	$(1,817)	$278,087

The following table summarizes contractual maturities of the Company's cash equivalent and marketable fixed-income securities as of December 31, 2001:

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Due within one year	$454,190	$449,391
Due after one year through three years	150,786	151,253
Asset-backed and agency securities with various maturities	231,912	232,821
	$836,888	$833,465

Gross gains of $9 million, $7 million, and $7 million and gross losses of $32 million, $11 million and $15 million were realized on sales of available-for-sale marketable securities for the years ended December 31, 2001, 2000, and 1999 respectively.

The Company has pledged a portion of its marketable securities as collateral for stand-by letters of credit that guarantee certain of its contractual obligations, a majority of which relates to property leases; the swap agreement that hedges foreign-exchange rate risk on a portion of its 6.875% PEACS; and some of its real estate lease agreements. See Note 7 and Note 8 of these "Notes to Consolidated Financial Statements."

Note 3—FIXED ASSETS

Fixed assets, at cost, consist of the following:

	December 31, 2001	December 31, 2000
	(in thousands)	
Computers, equipment and software	$ 205,687	$262,103
Internal software, website and content development	62,754	34,358
Leasehold improvements	102,412	107,367
Leased assets	42,444	51,969
Construction in progress	24,846	25,467
	438,143	481,264
Less accumulated depreciation	(152,443)	(99,244)
Less accumulated amortization on leased assets	(13,949)	(15,604)
Fixed assets, net	$ 271,751	$366,416

Fixed assets purchased under capital leases consist of computers, equipment and software.

Depreciation expense on fixed assets was $83 million, $83 million and $35 million, which includes amortization of fixed assets acquired under capital lease obligations of $9 million, $11 million and $6 million, for the years ended December 31, 2001, 2000 and 1999, respectively.

Note 4—GOODWILL AND OTHER INTANGIBLES

Goodwill and other intangibles were as follows:

	December 31, 2001	December 31, 2000
	(in thousands)	
Goodwill, net of adjustments	$ 617,827	$ 776,208
Accumulated amortization	(572,460)	(454,433)
Impairment adjustments	—	(162,785)
Goodwill, net	$ 45,367	$ 158,990
Other intangibles, net of adjustments	$ 221,879	$ 241,357
Accumulated amortization	(187,497)	(123,848)
Impairment adjustments	—	(21,174)
Other intangibles, net	$ 34,382	$ 96,335

During the fourth quarter of 2000, the Company identified indicators of possible impairment of its recorded goodwill and other intangibles. Such indicators included the general slowdown in the retail economy evidenced by general declines in consumer spending, the Company's decline in market capitalization as determined by the quoted market price for its common stock, the pervasive and significant declines in e-commerce valuations in comparison with the market valuations at the time the Company invested in its acquisitions, and changes in the Company's strategic plans for certain of the acquired businesses. Based on the results of its discounted cash flow analyses, the Company identified certain levels of impairment corresponding with the business-unit goodwill and other intangibles initially recorded in connection with the following acquisitions: Alexa Internet, Back to Basics Toys, Inc., Livebid, Inc., and the catalog and internet assets of Acme Electric Motor Co. ("Tool Crib"). Accordingly, the Company recorded an impairment loss of $184 million during the fourth quarter of 2000 included in "Restructuring-related and other" on the consolidated statements of operations.

Note 5—INVESTMENTS

At December 31, 2001, the Company's equity-method investees and the Company's approximate ownership interest in each investee, based on outstanding shares, were as follows:

Company	Percentage Ownership
Altura International	20%
Basis Technology	9
Daksh.com	11
drugstore.com	20
Eziba.com	20

The Company's voting interest in each investee, its representation on the investees' Boards of Directors and the effect of commercial arrangements result in the Company having significant influence over the operations of each investee.

Summarized balance sheet information of the Company's equity-method investees (generally one month in arrears for private companies and three months in arrears for public companies) is as follows:

	December 31, 2001	December 31, 2000
	(unaudited) (in thousands)	
Current assets	$153,185	$279,487
Noncurrent assets	242,728	511,671
Current liabilities	51,652	71,954
Noncurrent liabilities	2,074	113,258

Summarized statement of operations information of the Company's equity-method investees (generally one month in arrears for private companies and three months in arrears for public companies), calculated for each investee for the period during which the Company had investments in such investee, is as follows:

	For the Years Ended December 31, 2001	2000	1999
		(unaudited) (in thousands)	
Net sales	$ 155,797	$ 133,821	$ 27,996
Gross profit (loss)	30,226	42,402	(3,072)
Net loss	(160,335)	(453,263)	(152,541)

Activity in the Company's equity-method investments and other equity investments for the years ended December 31, 2000 and 2001, is as follows:

	Equity-Method Investments	Other Equity Investments	Total
		(in thousands)	
Balance, December 31, 1999	$ 226,727	$ 144,735	$ 371,462
Investments — cash consideration	48,091	13,485	61,576
Fair value of equity securities received in services-related transactions	80,190	26,658	106,848
Equity-method losses, net	(304,596)	—	(304,596)
Sales of investments	(41)	(9,163)	(9,204)
Realized gains (losses) on sales of investments	(2,763)	8,156	5,393
Basis adjustments for public offerings of investees	76,898	—	76,898
Non-cash gain, acquisition of Homegrocer.com, Inc. by Webvan Group, Inc.	40,160	—	40,160
Loss resulting from Living.com bankruptcy	(14,092)	—	(14,092)
Losses resulting from other-than-temporary declines in fair value	—	(100,726)	(100,726)
Unrealized gains on available-for-sale investments, net	—	693	693
Investment reclassifications, net, at fair value	(98,501)	(43,661)	(142,162)
Balance, December 31, 2000	52,073	40,177	92,250
Investments — common stock consideration	5,000	—	5,000
Fair value of equity securities received in services-related transactions	331	—	331
Equity-method losses, net	(30,327)	—	(30,327)
Sales of investments	(800)	(28)	(828)
Realized gains (losses) on sales of investments	800	—	800
Non-cash gains (losses) for acquisitions of investees by a third party	1,242	(458)	784
Losses resulting from other-than-temporary declines in fair value	(16,696)	(10,189)	(26,885)
Unrealized gains on available-for-sale investments, net	—	227	227
Losses for change in fair value of warrant investments, net	—	(5,293)	(5,293)
Loss from change in accounting principle	—	(7,700)	(7,700)
Investment reclassifications, net, at fair value	(1,236)	1,236	—
Balance, December 31, 2001	$ 10,387	$ 17,972	$ 28,359

Effective January 1, 2001 the Company's adoption of SFAS No. 133 resulted in the recording of a loss totaling $8 million to report certain net share warrant investments at fair value. Prior to adoption such warrants were carried at cost.

During 2000, the Company recorded unrealized gains, net of unrealized losses, as additional paid-in capital totaling $77 million as a result of public offerings of common stock by three of the Company's equity method investees at the time, Homegrocer.com, Inc., Pets.com, Inc., and drugstore.com, inc. The unrealized gains, net represent the difference between the Company's carrying basis and the fair value of the portion of each investment deemed to have been sold by the investee.

During 2001 and 2000, reclassifications from "Investments in equity method investees" resulted from acquisitions of investees by unrelated third parties and the corresponding loss of significant influence over the investees. Such reclassifications are either to “Other equity investments” or “Marketable securities” depending on the marketability of the investments and whether the Company had the intent to hold such investments for over one year from the date of reclassification. During 2000, net reclassifications in “Other equity investments” are a combination of reclassifications in from “Investments in equity method investees” and reclassifications out to “Marketable securities” as the Company no longer had the intent to hold certain investments for over one year from the date of reclassification.

At December 31, 2001 and 2000, “Other equity investments” included $3 million and $7 million of equity securities and warrant investments recorded at fair value and $15 million and $33 million of equity securities accounted for under the cost-method, respectively. Gross unrealized gains and losses were not significant at December 31, 2001. At December 31, 2000 gross unrealized gains were zero and gross unrealized losses were $3 million.

At December 31, 2001 and 2000, the Company’s investments in the common stock of publicly held equity-method investees, at fair value, were $25 million and $12 million, respectively.

Note 6—UNEARNED REVENUE

Activity in unearned revenue was as follows (in thousands):

Balance, December 31, 1999	$ 54,790
Cash received or cash receivable	97,818
Fair value of equity securities received	106,848
Amortization to revenue	(108,211)
Contract termination	(20,128)
Balance, December 31, 2000	131,117
Cash received or cash receivable	114,738
Fair value of equity securities received	331
Amortization to revenue	(135,808)
Contract termination	(22,400)
Balance, December 31, 2001	$ 87,978

During 2001, the Company recognized previously unearned revenue associated with the termination of its commercial agreement with Kozmo.com, which was included in “Other gains (losses), net” on the accompanying consolidated statements of operations. Since services had not yet been performed under the contract, no amounts associated with the Kozmo.com commercial agreement were previously recognized in “Net sales” on the accompanying consolidated statements of operations during any period.

During 2000, living.com, Inc. declared bankruptcy and terminated its commercial agreement with the Company. As a result, the Company recorded a net gain of $6 million, comprised of a $14 million loss representing the Company’s remaining investment balance in living.com and a $20 million gain relating to the unamortized portion of unearned revenue associated with the living.com commercial agreement. The gain and the loss are recorded net and included in “Other gains (losses), net” on the accompanying consolidated statements of operations.

Note 7—LONG-TERM DEBT AND OTHER

The Company's long-term debt and other long-term liabilities are summarized as follows:

	December 31, 2001	December 31, 2000
	(in thousands)	
6.875% PEACS	$ 608,787	$ 650,463
Euro Currency Swap	33,265	—
4.75% Convertible Subordinated Notes	1,249,807	1,249,807
Senior Discount Notes	231,830	210,278
Capital Lease Obligations	16,415	24,837
Long-term Restructuring	20,640	—
Other Long-term Debt	10,381	8,656
	2,171,125	2,144,041
Less current portion of long-term debt	(5,070)	(4,831)
Less current portion of capital lease obligations	(9,922)	(11,746)
	$2,156,133	$2,127,464

6.875% PEACS

On February 16, 2000, the Company completed an offering of 690 million Euros of 6.875% PEACS due 2010. The 6.875% PEACS are convertible into the Company's common stock at a conversion price of 84.883 Euros per share. The initial conversion price of the 6.875% PEACS was 104.947 Euros per share, which was adjusted down to the current price on February 16, 2001 due to a reset provision in the note. The conversion price can be reset a final time on February 16, 2002, but in no event will the price be reset lower than the current 84.883 Euros per share. Interest on the 6.875% PEACS is payable annually in arrears in February of each year. The 6.875% PEACS are unsecured and are subordinated to all of the Company's existing and future senior indebtedness. The 6.875% PEACS rank equally with the Company's outstanding 4.75% Convertible Subordinated Notes. Subject to certain conditions, the 6.875% PEACS may be redeemed at the Company's option on or after February 20, 2003, in whole or in part, at the redemption price of 1,000 Euros per note, plus accrued and unpaid interest.

In order to hedge a portion of the risk of exchange rate fluctuations between the U.S. dollar and the Euro, the Company entered into a cross-currency swap agreement and into a series of foreign currency forward purchase agreements in 2000. Under the swap agreement, the Company agreed to pay at inception and receive upon maturity 75 million Euros in exchange for receiving at inception and paying at maturity $67 million. In addition, the Company agreed to receive in February of each year 27 million Euros for interest payments on 390 million Euros of the 6.875% PEACS and, simultaneously, to pay $32 million. The agreement expires February 16, 2010 and is cancelable, in whole or in part, at the Company's option at no cost on or after February 20, 2003 if the Company's underlying stock price (converted into Euros) is greater than or equal to the minimum conversion price of the 6.875% PEACS. The Company has designated the swap agreement as a cash flow hedge of the foreign exchange rate risk on a portion of the 6.875% PEACS principal and interest in accordance with the guidelines of SFAS No. 133 adopted January 1, 2001. Each period, gains or losses resulting from changes in the fair value of the swap contract are recorded to "Accumulated other comprehensive loss" and a portion of such gain or loss is immediately reclassified to the statement of operations, "Other gains (losses), net," to offset the foreign currency loss or gain attributable to remeasurement of the hedged portion of the 6.875% PEACS. For the year ended December 31, 2001, a currency swap loss of $5 million was reclassified to offset a $5 million currency gain on the 6.875% PEACS. The terms of the swap contract have been structured to match the terms of the hedged portion of the 6.875% PEACS. No net gains or losses, resulting from hedge ineffectiveness, were recognized in results of operations during the year ended December 31, 2001. At December 31, 2001, under the terms of the swap agreement the Company had $48 million of its marketable securities pledged as collateral. Under the forward purchase agreements, the Company agreed to pay $18 million and receive 21 million Euros in February 2001. The Company designated these agreements as cash flow hedges of the foreign exchange rate risk on a portion of the 6.875% PEACS' interest payment paid on February 16, 2001. The effect on results of operations, relating to forward purchase agreements for the year ended December 31, 2001, was not significant.

Effective January 1, 2001, currency gains and losses arising from the remeasurement of the 6.875% PEACS's principal from Euros to U.S. dollars each period are recorded to "Other gains (losses), net." Prior to January 1, 2001, 6.875% PEACS's principal of 615 million Euros was designated as a hedge of an equivalent amount of Euro-denominated investments classified as available-for-sale; accordingly, currency gains and losses on the 6.875% PEACS were recorded to "Accumulated other comprehensive loss" on the consolidated balance sheets as hedging offsets to currency gains and losses on the Euro-denominated investments. As the hedge does not qualify for hedge accounting under the provisions of SFAS No. 133, commencing January 1, 2001, the foreign currency change resulting from the portion of the 6.875% PEACS previously hedging the available-for-sale securities is now being recorded to "Other gains (losses), net" on the consolidated statements of operations. The change resulted in a gain of $47 million for the year ended December 31, 2001, consisting of a $10 million gain reclassified from "Accumulated other comprehensive loss" and a $37 million gain attributable to remeasurement of the 6.875% PEACS during the period.

The fair value of the swap is determined as the present value of net future cash payments and receipts, adjusted for the Company's ability to cancel the agreement and the likelihood of such cancellation. The fair value takes into consideration current foreign currency exchange rates, market interest rates and the current market price of the Company's common stock. The fair value of the swap obligation was $33 million and $11 million at December 31, 2001 and December 31, 2000, respectively. No forward purchase agreements were outstanding at December 31, 2001. The fair value of the forward purchase agreements, as of December 31, 2000, was $1 million. Based upon quoted market prices, the fair value of the 6.875% PEACS, as of December 31, 2001 and December 31, 2000 was $310 million and $248 million, respectively.

4.75% Convertible Subordinated Notes

On February 3, 1999, the Company completed an offering of $1.25 billion of 4.75% Convertible Subordinated Notes due 2009. The 4.75% Convertible Subordinated Notes are convertible into the Company's common stock at the holders' option at a conversion price of $78.0275 per share, subject to adjustment in certain events. Interest on the 4.75% Convertible Subordinated Notes is payable semi-annually in arrears on February 1 and August 1 of each year, and commenced August 1, 1999. The 4.75% Convertible Subordinated Notes are unsecured and are subordinated to all existing and future Senior Indebtedness as defined in the indenture governing the 4.75% Convertible Subordinated Notes. At any time on or after February 6, 2002 on at least 30 days' notice the Company may redeem the notes, in whole or in part, at a premium of 3.325% over its principal balance, together with accrued interest. The redemption premium is thereafter reduced by 0.475% on each February 1 between 2003 and 2009.

Upon the occurrence of a "fundamental change" (as defined in the indenture governing the 4.75% Convertible Subordinated Notes) prior to the maturity of the 4.75% Convertible Subordinated Notes, each holder thereof has the right to require the Company to redeem all or any part of such holder's 4.75% Convertible Subordinated Notes at a price equal to 100% of the principal amount of the notes being redeemed, together with accrued interest.

Based upon quoted market prices, the fair value of the 4.75% Convertible Subordinated Notes as of December 31, 2001 and December 31, 2000 was $625 million and $471 million, respectively.

Senior Discount Notes

In 1998, the Company completed the offering of approximately $326 million of 10% Senior Discount Notes due May 1, 2008 ("Original Senior Discount Notes"). Pursuant to a registration statement on Form S-4 in September 1998, the Company completed an exchange offer of 10% Senior Discount Notes due 2008 ("Exchange Notes" or "Senior Discount Notes"), which are registered under the Securities Act of 1933, as amended, for all outstanding Original Senior Discount Notes. The Exchange Notes have identical terms in all material respects to the terms of the Original Senior Discount Notes, except that the Exchange Notes generally are freely transferable (the Exchange Notes are referred to throughout these notes to consolidated financial statements interchangeably with the Original Senior Discount Notes). The Exchange Notes were issued under the indenture governing the Original Senior Discount Notes ("Indenture"). The Original Senior Discount Notes were sold at a substantial discount from their principal amount at maturity of $530 million. Prior to November 1, 2003, no cash interest payments are required; instead, interest will accrete during this period to the aggregate principal amount at maturity. From and after May 1, 2003, the Senior Discount Notes will bear interest at a rate of 10% per annum payable in cash on each May 1 and November 1. The Senior Discount Notes are redeemable, at the option of the Company, in whole or in part, at any time on or after May 1, 2003, at the redemption prices set forth in the Indenture, plus accrued interest, if any, to the date of redemption.

During 1999, the Company repurchased $266 million (principal amount) of the Senior Discount Notes, representing accreted value of $178 million. The Company recorded an immaterial loss on extinguishment of this debt. No repurchases of Senior Discount Notes occurred in 2001 or 2000.

The Senior Discount Notes are senior unsecured indebtedness of the Company ranking equally with the Company's existing and future unsubordinated, unsecured indebtedness and senior in right of payment to all subordinated indebtedness of the Company. The Senior Discount Notes are effectively subordinated to all secured indebtedness and to all existing and future liabilities of the Company's subsidiaries.

The Indenture contains certain covenants that, among other things, limit the ability of the Company and its Restricted Subsidiaries (as defined in the Indenture) to incur indebtedness, pay dividends, prepay subordinated indebtedness, repurchase capital stock, make investments, create liens, engage in transactions with stockholders and affiliates, sell assets and engage in mergers and consolidations. However, these limitations are subject to a number of important qualifications and exceptions. The Company was in compliance with all financial covenants at December 31, 2001 and 2000.

Based upon quoted market prices, the fair value of the outstanding Senior Discount Notes as of December 31, 2001 and December 31, 2000 was $194 million and $134 million, respectively.

Note 8—COMMITMENTS AND CONTINGENCIES

Commitments

The Company currently leases office and fulfillment center facilities and fixed assets under noncancelable operating and capital leases. Rental expense under operating lease agreements for 2001, 2000 and 1999 was $81 million, $98 million and $43 million, respectively.

Future minimum commitments are as follows:

	Restructuring-Related Commitments				Other Commitments			
	Leases	Termination Benefits	Other	Sub-Total	Capital Leases	Operating Leases	Marketing Agreements	Total
				(in thousands)				
Year Ending December 31,								
2002	$35,578	$ 61	$5,159	$40,798	$11,339	$ 60,837	$16,411	$129,385
2003	5,476	—	3,031	8,507	6,573	57,501	217	72,798
2004	2,016	—	—	2,016	41	48,729	—	50,786
2005	1,983	—	—	1,983	—	41,953	—	43,936
2006	2,068	—	—	2,068	—	42,400	—	44,468
Thereafter	6,066	—	—	6,066	—	206,373	—	212,439
Total estimated cash outflows	$53,187	$ 61	$8,190	$61,438	$17,953	$457,793	$16,628	$553,812
Less imputed interest					(1,538)			
Present value of net minimum lease payments					16,415			
Less current portion					(9,922)			
Long-term capital lease obligation					$ 6,493			

At December 31, 2001, the Company remains obligated under gross lease obligations of $121 million associated with its operational restructuring and anticipates receiving sub-lease income of $68 million to offset these obligations, of which $17 million are to be received under non-cancelable subleases.

Stand-by Letters of Credit

At December 31, 2001, the Company pledged marketable securities of $78 million as collateral for stand-by letters of credit that guarantee certain of its contractual obligations, a majority of which relates to property leases. In addition, under the terms of certain real estate lease agreements, the Company has pledged $41 million of its marketable securities.

Legal Proceedings

As previously disclosed in our Quarterly Report on Form 10-Q for the third quarter of 2000, we have received informal inquiries from the staff of the Securities and Exchange Commission Staff (the “SEC”) with respect to the accounting treatment and disclosures for some of our initial strategic alliances and have been cooperating with the SEC staff in responding to those inquiries. We reviewed our accounting treatment for the transactions with our independent auditors and the SEC staff, and we believe our accounting treatment and disclosures were appropriate. The SEC staff recently notified us that it believes the other party to one such transaction, Ashford.com, improperly reported the resolution of a business dispute with us, and that it is considering whether the Company, or any of its officers or employees may have facilitated Ashford.com’s conduct. While there can be no assurance that the SEC will not pursue an enforcement action, we believe our actions at all times were proper and that this matter will not materially affect our results of operations or financial condition.

On April 12, 2001, the Company received a request from the SEC staff for the voluntary production of documents and information concerning, among other things, previously reported sales of the Company's common stock by Jeffrey Bezos on February 2 and 5, 2001. The Company is cooperating with the SEC staff's continuing inquiry.

A number of purported class action complaints were filed by holders of Amazon.com equity and debt securities against the Company, its directors and certain of its senior officers during 2001, in the United States District Court for the Western District of Washington, alleging violations of the Securities Act of 1933 (the "1933 Act") and/or the Securities Exchange Act of 1934 (the "1934 Act"). On October 5, 2001, plaintiffs in the 1934 Act cases filed a consolidated amended complaint alleging that the Company, together with certain of its officers and directors and certain third-parties, made false or misleading statements during the period from October 29, 1998 through July 23, 2001 concerning the Company's business, financial condition and results, inventories, future prospects, and strategic alliance transactions. The 1933 Act complaint alleges that the defendants made false or misleading statements in connection with the Company's February 2000 offering of the 6.875% PEACS. The complaints seek recissionary and/or compensatory damages and injunctive relief against all defendants. The Company disputes the allegations of wrongdoing in these complaints and intends to vigorously defend itself in these matters.

Depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect the Company's business, future results of operations, financial position or cash flows in a particular period.

From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights, patents and other intellectual property rights. The Company currently is not aware of any such legal proceedings or claims that management believes will have, individually or in the aggregate, a material adverse effect on the Company's business, financial condition or operating results.

Inventory Suppliers

During 2001, approximately 21% of all inventory purchases were made from three major vendors, of which Ingram Book Group accounts for over 10%. The Company does not have long-term contracts or arrangements with most of its vendors to guarantee the availability of merchandise, particular payment terms or the extension of credit limits.

Note 9—STOCKHOLDERS' EQUITY (DEFICIT)

Preferred Stock

The Company has authorized 500,000,000 shares of $0.01 par value Preferred Stock. No preferred stock shares were outstanding during 2001, 2000 or 1999.

Common Stock

On January 4, 1999, the Company effected a 3-for-1 stock split in the form of a stock dividend to the stockholders of record on December 18, 1998. On September 1, 1999, the Company effected a 2-for-1 stock split in the form of a stock dividend to stockholders of record on August 12, 1999. The accompanying consolidated financial statements reflect these stock splits.

Stock Option Plans

The Company's stock option plans consist of the 1999 Nonofficer Employee Stock Option Plan, the 1997 Stock Incentive Plan and the Amended and Restated 1994 Stock Option Plan. Shares reserved under these Plans at December 31, 2001 consist of 40 million shares in the 1999 Nonofficer Employee Stock Option Plan, 94 million shares in the 1997 Stock Incentive Plan and 58 million shares in the 1994 Stock Option Plan, of which up to a maximum of 21,025,075 shares that are not issued under that plan may be added to the aggregate number of shares available for issuance under the 1997 Stock Incentive Plan. In connection with certain acquisitions in 1999, the Company assumed outstanding options to purchase common stock originally issued under the acquired companies' stock option plans. The Company's stock option plans as well as the assumed stock option plans are hereby collectively referred to as the "Plans."

Generally, the Company's Board of Directors grants options at an exercise price of not less than the fair market value of the Company's common stock at the date of grant. Each outstanding option granted prior to December 20, 1996 has a term of five years from the date of vesting. Generally, outstanding options granted on or subsequent to December 20, 1996 have a term of 10 years from the date of grant. Subject to Internal Revenue Service limitations, options granted under the Company's plans prior to April 1999 and granted under certain assumed plans generally became exercisable immediately but are subject to a restriction on transfer that vests over a period of time. Options granted under the Plans since April 1999 generally vest and become exercisable in accordance with the following vesting schedule: 20% after year one, 20% after year two and 5% at the end of each quarter for years three through five. Certain outstanding options that were granted during 2000 and 2001 vest and become exercisable at the rate of 50% after year one and 50% after year two. During the first quarter of 2001, the Company offered a limited non-compulsory exchange of employee stock options to employees meeting certain eligibility criteria. Options granted pursuant to this stock option exchange vest and become exercisable at the rate of 25% after 6 months from the date of grant and 4.166% per month for the succeeding 18 months. Certain options granted in the third quarter of 2001 generally vest and become exercisable as follows: (i) the option vests quarterly in equal installments over a 36, 48 or 60 month period commencing on dates ranging from grant date to October 1, 2003, (ii) the option vests 5% to 12.5% on a date approximately 12 to 16 months from date of grant with the balance vesting quarterly in equal installments over a 48 to 60 month period or (iii) the option vests 4% to 12.5% on dates approximately 6 months and 18 months from the date of grant with the balance vesting quarterly in equal installments over a 24 or 60 month period. Shares issued upon exercise of options that are unvested are restricted and subject to repurchase by the Company at the exercise price upon termination of employment or services and such restrictions lapse over the original vesting schedule. At December 31, 2001, approximately 1.1 million shares of restricted common stock, which includes restricted shares issued in connection with acquisitions, as well as shares issued to certain key employees in 2001, were subject to repurchase or forfeiture.

Stock Option Activity

The following table summarizes the Company's stock option activity:

	Number of Shares (in thousands)	Weighted Average Exercise Price
Balance January 1, 1999	76,009	$ 6.69
Options granted and assumed	31,379	63.60
Options canceled	(11,281)	19.70
Options exercised	(16,125)	4.00
Balance December 31, 1999	80,342	27.76
Options granted and assumed	20,717	38.13
Options canceled	(19,502)	37.19
Options exercised	(11,119)	4.02
Balance December 31, 2000	70,438	32.17
Net effect of option exchange:		
Options granted	12,503	13.38
Options exchanged and canceled	(31,170)	51.94
Net effect of option exchange	(18,667)	
Options granted	33,706	8.10
Options canceled	(13,438)	25.29
Options exercised	(6,089)	2.73
Balance December 31, 2001	65,950	10.65

At December 31, 2001, 63 million shares of common stock were available for future grant under the Plans.

The following table summarizes information about options outstanding and exercisable at December 31, 2001:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options (in thousands)	Remaining Life (yrs)	Weighted Average Exercise Price	Number of Options (in thousands)	Weighted Average Exercise Price
$ 0.03 – $ 1.00	5,000	5.0	$0.42	4,222	$0.39
1.17 – 5.37	5,095	5.9	4.01	1,943	3.85
5.81 – 7.86	4,838	6.8	7.13	2,360	7.11
7.93 – 7.93	26,071	9.7	7.93	—	7.93
7.95 – 8.55	3,660	8.5	8.51	263	8.23
8.72 – 13.24	1,872	8.2	11.40	471	11.86
13.38 – 13.38	10,712	1.8	13.38	4,227	13.38
13.57 – 19.89	3,602	7.3	16.76	1,575	17.04
20.06 – 104.97	5,100	7.7	35.77	1,903	30.53
0.03 – 104.97	65,950	7.1	10.65	16,964	10.32

Deferred Stock-Based Compensation

The Company recorded aggregate deferred stock-based compensation of $9 million, zero and $72.1 million in 2001, 2000 and 1999, respectively. In 2001, deferred stock-based compensation was recorded in connection with restricted Company stock issued to key employees. The amount recorded represents the fair value of the Company's common stock issued on the date of grant. In 1999, deferred compensation was recorded in connection with acquisitions made by the Company in which restricted Company common stock was issued to employees of acquired companies. The Company's common stock issued in 2001 and 1999 is considered compensation for services to be provided by employees, and the related expense will be recognized over the term of the services provided, which is generally five years. In 2001 and 2000, the company recorded an adjustment to reduce previously recorded deferred stock-based compensation of $4 million and $3 million, respectively. The adjustments related to the termination of employment prior to vesting of certain employees acquired from business combinations. Total amortization expense recognized in 2001, 2000 and 1999 related to deferred stock-based compensation was $8 million, $32 million and $26 million, respectively.

Comprehensive Loss

The changes in the components of comprehensive loss were as follows:

	Year Ended December 31,		
	2001	2000	1999
		(in thousands)	
Net loss	$(567,277)	$(1,411,273)	$(719,968)
Other comprehensive loss:			
Foreign-currency translations gains (losses), net	(1,257)	(364)	490
Net unrealized gains (losses) on available-for-sale securities:			
Unrealized losses arising during year	(33,479)	(178,815)	(12,698)
Less reclassification of net realized losses included in net loss	40,484	178,512	8,693
Net unrealized gains (losses) on available-for-sale securities	7,005	(303)	(4,005)
Net unrealized losses on Euro-based currency swap:			
Unrealized losses on remeasurement to fair value	(21,867)	—	—
Reclassification of losses to offset currency gains on hedged portion of 6.875% PEACS included in net loss	4,530	—	—
Net unrealized losses on Euro-based currency swap	(17,337)	—	—
Reclassification of currency gains on 6.875% PEACS	(9,811)	—	—
Cumulative effect of accounting change to adopt SFAS No. 133	(12,294)	—	—
Other comprehensive loss	$ (33,694)	(667)	(3,515)
Comprehensive loss	$(600,971)	$(1,411,940)	$(723,483)

SFAS No. 123 Pro Forma Disclosure

The Company uses the intrinsic value method in accounting for its stock options. If compensation cost had been recognized based on the fair value at the date of grant for options granted in 2001, 2000 and 1999, under SFAS No. 123, "Accounting for Stock-Based Compensation," pro forma amounts of the Company's net loss and net loss per share, which may not necessarily be indicative of effects on reported results for future years, for the years ended December 31, 2001, 2000 and 1999 would have been as follows:

	For the Years Ended December 31,		
	2001	2000	1999
	(in thousands, except per share data)		
Net loss — as reported	$(567,277)	$(1,411,273)	$ (719,968)
Net loss — SFAS No. 123 pro forma	(963,085)	(1,720,312)	(1,031,925)
Basic and diluted loss per share — as reported	$ (1.56)	$ (4.02)	$ (2.20)
Basic and diluted loss per share — SFAS No. 123 pro forma	(2.64)	(4.90)	(3.16)

The fair value for each option granted was estimated at the date of grant using a Black-Scholes option-pricing model, assuming no expected dividends and the following weighted average assumptions:

	For the Years Ended December 31,		
	2001	2000	1999
Average risk-free interest rates	4.1%	6.2%	5.5%
Average expected life (in years)	3.3	3.0	3.5
Volatility	98.0%	89.6%	84.9%

The weighted average fair value of options granted during 2001, 2000 and 1999 was $5.98, $22.12 and $43.36, respectively, for options granted with exercise prices at the current fair value of the underlying stock. Compensation expense that is recognized in providing pro forma disclosures might not be representative of the effects on pro forma earnings for future years because SFAS No. 123 does not apply to stock option grants made prior to 1995.

Common Stock Reserved for Future Issuance

At December 31, 2001, common stock reserved for future issuance is as follows (in thousands):

Stock options	129,324
Shares issuable upon conversion of 4.75% Convertible Subordinated Notes	16,017
Shares issuable upon conversion of 6.875% PEACS	8,129
Total	153,470

Note 10—EARNINGS (LOSS) PER SHARE

The following represents the calculations for net loss per share:

	For the Years Ended December 31,		
	2001	2000	1999
	(in thousands, except per share data)		
Loss before change in accounting principle	$(556,754)	$(1,411,273)	$(719,968)
Cumulative effect of change in accounting principle	(10,523)	—	—
Net loss	$(567,277)	$(1,411,273)	$(719,968)
Weighted average shares outstanding	365,180	353,394	332,409
Weighted average common shares issued subject to repurchase agreements	(969)	(2,521)	(5,656)
Shares used in computation of basic and diluted loss per share	364,211	350,873	326,753
Basic and diluted loss per share:			
Prior to cumulative effect of change in accounting principle	$ (1.53)	$ (4.02)	$ (2.20)
Cumulative effect of change in accounting principle	(0.03)	—	—
	$ (1.56)	$ (4.02)	$ (2.20)

All of the Company's stock options (see Note 9) are excluded from diluted loss per share since their effect is antidilutive.

Note 11—STOCK-BASED COMPENSATION

During the first quarter of 2001, the Company offered a limited non-compulsory exchange of employee stock options. The exchange resulted in the voluntary cancellation of employee stock options to purchase 31 million shares of common stock with varying exercise prices in exchange for 12 million employee stock options with an exercise price of $13.375. The option exchange offer resulted in variable accounting treatment for, at the time of the exchange, approximately 15 million stock options, which includes options granted under the exchange offer and 3 million options, with a weighted average exercise price of $52.41, that were subject to the exchange offer but were not exchanged. Variable accounting will continue until all options subject to variable accounting treatment are exercised, cancelled or expired. At December 31, 2001, approximately 12 million options remain under variable accounting treatment, which includes 11 million options granted under the exchange offer and 1 million options, with a weighted average exercise price of $39.61, that were subject to the exchange offer but were not exchanged.

Stock-based compensation includes stock-based charges resulting from variable accounting treatment of certain options, option-related deferred compensation recorded at the Company's initial public offering, as well as certain other compensation and severance arrangements. Stock-based compensation also includes the portion of acquisition-related consideration conditioned on the continued tenure of key employees of certain acquired businesses, which must be classified as compensation expense rather than as a component of purchase price under accounting principles generally accepted in the United States. The following table shows the amounts of stock-based compensation that would have been recorded under the following categories had stock-based compensation not been separately stated on the consolidated statements of operations.

	For the Years Ended December 31,		
	2001	2000	1999
		(in thousands)	
Fulfillment	$ 481	$ (1,606)	$ 188
Marketing	690	(858)	3,957
Technology and content	2,723	28,253	25,322
General and administrative	743	(992)	1,151
	$4,637	$24,797	$30,618

Note 12—RESTRUCTURING-RELATED AND OTHER

Restructuring-related and other expenses were $182 million, $200 million and $8 million for 2001, 2000 and 1999, respectively. In the first quarter of 2001, the Company announced and began implementation of its operational restructuring plan to reduce operating costs, streamline its organizational structure, and consolidate certain of its fulfillment and customer service operations. This initiative involved the reduction of employee staff by approximately 1,300 positions throughout the Company in managerial, professional, clerical, technical and fulfillment roles; consolidation of its Seattle, Washington corporate office locations; closure of its McDonough, Georgia fulfillment center; seasonal operation of its Seattle, Washington fulfillment center (if necessary); closure of its customer service centers in Seattle, Washington and The Hague, Netherlands; and migration of a large portion of its technology infrastructure to a new operating platform, which entails ongoing lease obligations for technology infrastructure no longer being utilized. Each component of the restructuring plan has been substantially completed. As of December 31, 2001, 1,327 employees had been terminated, and actual termination benefits paid were $12 million.

Costs that relate to ongoing operations are not part of restructuring charges and are not included in "Restructuring-related and other." In accordance with EITF Issue No. 96-9, "Classification of Inventory

Markdowns and Other Costs Associated with a Restructuring," all inventory adjustments that may result from the closure or seasonal operation of the Company's fulfillment centers are classified in "Cost of goods sold" on the consolidated statements of operations. As of December 31, 2001, there have been no significant inventory write downs resulting from the restructuring, and none are anticipated.

For the year ended December 31, 2001, the charges associated with the restructuring were as follows (in thousands):

Asset impairments	$ 68,528
Continuing lease obligations	87,049
Termination benefits	14,970
Broker commissions, professional fees and other miscellaneous restructuring costs	11,038
	$181,585

Asset impairments primarily relate to the closure of the McDonough, Georgia fulfillment center, the write-off of leasehold improvements in vacated corporate office space, and the other-than-temporary decline in the fair value of assets in the Seattle, Washington fulfillment center. For assets to be disposed of, the Company estimated the fair value based on expected salvage value less costs to sell. For assets held for continued use, the decline in fair value was measured using discounted estimates of future cash flows. The Company is actively seeking third-party buyers for the assets held for disposal. At December 31, 2001 the carrying amount of assets held for disposal was not significant.

Continuing lease obligations primarily relate to heavy equipment previously used in the McDonough, Georgia fulfillment center, vacated corporate office space, technology infrastructure no longer being utilized, and the unutilized portion of the Company's back-up data center. Where possible, the Company is actively seeking third parties to sub-lease abandoned equipment and facilities. Amounts expensed represent estimates of undiscounted future cash outflows, offset by anticipated third-party sub-leases. At December 31, 2001, the Company remains obligated under lease obligations of $121 million associated with its January 2001 operational restructuring, offset by estimates of future sub-lease income of $68 million, of which $17 million are to be received under non-cancelable subleases.

Termination benefits are comprised of severance-related payments for all employees to be terminated in connection with the operational restructuring, as well as $2.5 million of the Company's common stock contributed to a trust fund for the benefit of terminated employees. Termination benefits do not include any amounts for employment-related services prior to termination. Other restructuring costs include professional fees, decommissioning costs of vacated facilities, broker commissions and other miscellaneous expenses directly attributable to the restructuring.

At December 31, 2001, the accrued liability associated with the restructuring-related and other charges was $61 million and consisted of the following (in thousands):

	Balance at March 31, 2001	Subsequent Accruals, net	Non-Cash Settlements and Other Adjustments	Payments	Balance at December 31, 2001	Due Within 12 Months	Due After 12 Months
Lease obligations	$34,667	$52,738	$(2,675)	$(31,543)	$53,187	$35,578	$17,609
Termination benefits	8,445	113	(2,354)	(6,143)	61	61	—
Broker commissions, professional fees and other miscellaneous restructuring costs	4,121	5,052	1,559	(2,542)	8,190	5,159	3,031
	$47,233	$57,903	$(3,470)	$(40,228)	$61,438	$40,798	$20,640

During 2000, the Company identified certain levels of impairment corresponding with the business-unit goodwill and other intangibles initially recorded in connection with the following acquisitions: Alexa Internet, Back to Basics Toys, Inc., Livebid, Inc. and the catalog and Internet assets of Acme Electric Motor Co. (Tool Crib). Accordingly, the Company recorded an impairment loss of $184 million. Also during 2000, the Company recorded an impairment loss of $11 million relating to the decline in fair value, measured using discounted estimates of future cash flows, of certain fixed assets. The fixed-asset impairment amount included $4 million, $3 million and $4 million of computers, equipment and software; leasehold improvements; and leased assets, respectively.

Other costs associated with the Company's acquisition-related activities were $5 million and $8 million for 2000 and 1999, respectively. No such amounts were recorded during 2001.

Note 13—OTHER GAINS (LOSSES), NET

Other gains (losses), net were recorded during 2001 and 2000. No such amounts were recorded during 1999. Other gains (losses), net consisted of the following:

	Years Ended December 31, 2001	2000
	(in thousands)	
Foreign-currency gains on 6.875% PEACS	$ 46,613	$ —
Losses on sales of Euro-denominated investments, net	(22,548)	—
Other-than-temporary impairment losses, equity investments	(43,588)	(188,832)
Contract termination by third parties	22,400	6,033
Net gains from acquisitions of investments by third parties	784	40,160
Warrant fair-value remeasurements and other	(5,802)	—
	$ (2,141)	$(142,639)

Effective January 1, 2001, currency gains and losses arising from the remeasurement of the 6.875% PEACS's principal from Euros to U.S. dollars each period are recorded to "Other gains (losses), net." Prior to January 1, 2001, 6.875% PEACS's principal of 615 million Euros was designated as a hedge of an equivalent amount of Euro-denominated investments classified as available-for-sale; accordingly, currency gains and losses on the 6.875% PEACS were recorded to "Accumulated other comprehensive loss" on the consolidated balance sheets as hedging offsets to currency gains and losses on the Euro-denominated investments. As the hedge does not qualify for hedge accounting under the provisions of SFAS 133, commencing January 1, 2001, the foreign currency change resulting from the portion of the 6.875% PEACS previously hedging the available-for-sale securities is now being recorded on the consolidated statements of operations. For 2001, the remeasurement of the 6.875% PEACS resulted in a gain of $47 million consisting of a $10 million gain reclassified from "Accumulated other comprehensive loss," and a $37 million gain attributable to remeasurement of the 6.875% PEACS during the period.

During 2001 and 2000, the Company recorded impairment losses, which totaled $44 million and $189 million, respectively, relating to other-than-temporary declines in certain equity investments. These impairments were recorded to reflect the investments at fair value as of the date of impairment. During 2001, the other-than-temporary declines in fair value of investments were associated with investments in Webvan Group, Inc, Sotheby's Holdings, Inc., WeddingChannel.com, Inc. Ashford.com, Inc., Audible, Inc., drugstore.com, inc., and Angel II Investors, L.P. During 2000, the other-than-temporary declines in fair value of investments were associated with Audible, NextCard, Inc., Webvan, Ashford.com, Greg Manning Auctions, Inc, and Sotheby's.

On February 5, 2001, the Company terminated its commercial agreement with Kozmo.com and recorded a non-cash gain of $22 million, representing the amount of unearned revenue associated with the contract. Since services had not yet been performed under the contract, no amounts associated with this commercial agreement were recognized in "Net sales" during any period. Furthermore, during 1999, the Company made a cash investment of $60 million to acquire preferred stock of Kozmo.com and accounted for its investment under the equity method of accounting. Pursuant to the equity method of accounting, the Company recorded its share of Kozmo.com losses, which, during 2000, reduced the Company's basis in its investment to zero. Accordingly, when Kozmo.com announced its intentions to cease operations on April 12, 2001, the Company did not have any further loss exposure relating to its investment. The Company will not recover any portion of its investment in Kozmo.com.

During 2000, the Company recorded a gain of $40 million relating to the acquisition of Homegrocer.com by Webvan and a $6 million net gain relating to the bankruptcy of Living.com that is comprised of a $14 million loss representing the Company's remaining investment balance in Living.com and a $20 million gain relating to the unamortized portion of unearned revenue associated with the Living.com commercial agreement.

Note 14—INCOME TAXES

The Company has provided for current and deferred U.S. federal, state and foreign income taxes for the current and all prior periods presented. Current and deferred income taxes were provided with respect to jurisdictions where subsidiaries of the Company produce taxable income. As of December 31, 2001, the Company has a net deferred tax asset of $2 million, which consists primarily of state net operating loss carryforwards. The Company has provided a valuation allowance for the remainder of its deferred tax asset, consisting primarily of net operating loss carry forwards, because of uncertainty regarding its realization. The increase in the valuation allowance on the deferred tax asset was $492 million and $226 million for 2001 and 2000, respectively.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

	December 31,	
	2001	2000
	(in thousands)	
Net operating loss carryforwards	$ 769,632	$ 576,024
Equity in losses of equity-method investees	152,502	—
Depreciation and amortization	148,450	9,777
Accrued expenses	53,186	32,050
Unearned revenue	37,834	39,916
Other	9,674	19,435
Total deferred tax assets	1,171,278	677,202
Valuation allowance for deferred tax assets	(1,169,130)	(677,202)
Net deferred tax assets	$ 2,148	$ —

At December 31, 2001, the Company had net operating loss carryforwards of approximately $2.3 billion related to U.S. federal, state and foreign jurisdictions. Utilization of net operating losses, which begin to expire at various times starting in 2010, may be subject to certain limitations. Approximately $1 billion of the Company's net operating loss carryforwards relates to deductible stock-based compensation in excess of amounts recognized for financial reporting purposes. To the extent that net operating loss carryforwards, if realized, relate to the portion associated with stock-based compensation, the resulting benefit will be credited to stockholders' equity, rather than results of operations.

Note 15—EMPLOYEE BENEFIT PLAN

The Company has a 401(k) savings plan covering substantially all of its employees. Eligible employees may contribute through payroll deductions. The Company matches employees' contributions at the discretion of the Company's Board of Directors. To date, the Company has not matched employee contributions to the 401(k) savings plan.

Note 16—SEGMENT INFORMATION

In January 2001, the Company began presenting information to its chief operating decision maker in four segments: U.S. Books, Music and DVD/Video; U.S. Electronics, Tools and Kitchen; Services; and International. Accordingly, the Company is now disclosing its segment financial information along these lines. Allocation methodologies are consistent with past presentations, and prior period amounts have been reclassified to conform with the current period presentation.

U.S. Books, Music and DVD/Video Segment

The U.S. Books, Music and DVD/Video Segment includes revenues, direct costs, and cost allocations associated with retail sales from *www.amazon.com* for books, music and DVDs/video products and for magazine subscriptions. This segment also includes product sales, commissions, direct costs and cost allocations from sales of these products, new or used, through Amazon Marketplace and from stores offering these products through the Company's Syndicated Stores Program, such as *www.borders.com*.

U.S. Electronics, Tools and Kitchen Segment

The U.S. Electronics, Tools and Kitchen segment includes revenues, direct costs and cost allocations associated with *www.amazon.com* retail sales of electronics, computers, camera and photo items, software, computer and video games, cell phones and service, tools and hardware, outdoor living items, kitchen and houseware products, toys and video games sold other than through the Company's strategic alliance with Toysrus.com, Inc., as well as catalog sales of toys, tools and hardware. This segment also includes commissions from sales of these products, new or used, through Amazon Marketplace and commissions and other amounts earned from offerings of these products by third-party sellers through the Company's Merchant@amazon.com Program, such as its strategic alliance with Circuit City.

Services Segment

The Services segment includes revenues, direct costs, and cost allocations associated with the Company's business-to-business strategic alliances, including the Merchant Program and, to the extent product categories are not also offered by the Company through its online retail stores, the Merchant@amazon.com Program, as well as the strategic alliance with America Online, Inc. This segment also includes Auctions, zShops and Payments, and miscellaneous marketing and promotional agreements.

In 2001, the Company entered into numerous strategic alliances with such companies as America Online and Target Corporation in the U.S., and Virgin Wines in the U.K. The Company also expanded its strategic alliance with Toysrus.com to include Babiesrus.com and Imaginarium.com co-branded stores at *www.amazon.com*. In addition, the Company entered into strategic alliances with Expedia, Inc., Hotwire and National Leisure Group, Inc. to create a travel store. Amounts associated with each of these strategic alliances are included in the Services segment. In 2001, the strategic alliance with Toysrus.com contributed a significant amount of revenue to the Services segment.

Included in service revenues are equity-based revenues of $27 million, $79 million and $7 million for 2001, 2000 and 1999 respectively. Equity-based service revenues result from private and public securities received and amortized into results of operations. Also included in services revenues are $2 million and $29 million for 2001 and 2000, respectively, representing amounts associated with sales of inventory, at cost, to Toysrus.com in connection with the transition of the toys and video games product categories to Toysrus.com. No such amounts were recorded during 1999.

International Segment

The International segment includes all revenues, direct costs, and cost allocations associated with the retail sales of the Company's four internationally-focused Web sites: *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr* and *www.amazon.co.jp*. These international sites share a common Amazon.com experience, but are localized in terms of language, products, customer service and fulfillment. This segment includes commissions and other amounts earned from offerings of products by third-party sellers through the Company's Merchant@amazon.com Program, and product revenues from stores offering these products through the Company's internationally-focused Syndicated Stores program, such as our Syndicated Store at *www.waterstones.co.uk*.

The Company measures the results of operations of its reportable segments using a pro forma measure. Pro forma results from operations, which excludes stock-based compensation, amortization of goodwill and other intangibles, and restructuring-related and other charges are not in conformity with accounting principles generally accepted in the United States.

Information on reportable segments and reconciliation to consolidated net loss is as follows:

	U.S. Retail					
	Books, Music and DVD/Video	Electronics, Tools and Kitchen	Total	Services	International	Consolidated
	(in thousands)					
2001:						
Net sales	$1,688,752	$ 547,190	$2,235,942	$225,117	$ 661,374	$ 3,122,433
Gross profit	453,129	78,384	531,513	126,439	140,606	798,558
Pro forma income (loss) from operations	156,753	(140,685)	16,068	42,042	(103,112)	(45,002)
Stock-based compensation						(4,637)
Amortization of goodwill and other intangibles						(181,033)
Restructuring-related and other						(181,585)
Net interest expense and other						(114,170)
Equity in losses of equity-method investees, net						(30,327)
Cumulative effect of change in accounting principle						(10,523)
Net loss						$ (567,277)

	U.S. Retail					
	Books, Music and DVD/Video	Electronics, Tools and Kitchen	Total	Services	International	Consolidated
	(in thousands)					
2000:						
Net sales	$1,698,266	$ 484,151	$2,182,417	$198,491	$ 381,075	$ 2,761,983
Gross profit	417,452	44,655	462,107	116,234	77,436	655,777
Pro forma income (loss) from operations	71,441	(269,890)	(198,449)	26,519	(145,070)	(317,000)
Stock-based compensation						(24,797)
Amortization of goodwill and other intangibles						(321,772)
Restructuring-related and other						(200,311)
Net interest expense and other						(242,797)
Equity in losses of equity-method investees, net						(304,596)
Net loss						$(1,411,273)

	U.S. Retail					
	Books, Music and DVD/Video	Electronics, Tools and Kitchen	Total	Services	International	Consolidated
			(in thousands)			
1999:						
Net sales	$1,308,292	$ 150,654	$1,458,946	$ 13,150	$167,743	$1,639,839
Gross profit	262,871	(20,086)	242,785	12,285	35,575	290,645
Pro forma income (loss) from operations	(31,000)	(163,827)	(194,827)	(78,321)	(79,223)	(352,371)
Stock-based compensation						(30,618)
Amortization of goodwill and other intangibles						(214,694)
Restructuring-related and other						(8,072)
Net interest expense and other						(37,444)
Equity in losses of equity-method investees, net						(76,769)
Net loss						$ (719,968)

Net sales to customers outside of the U.S. represented approximately 29%, 22% and 22% of net sales for 2001, 2000 and 1999, respectively. No individual foreign country or geographical area or customer accounted for more than 10% of net sales in any of the periods presented. There were no transfers between geographic areas during 2001, 2000 or 1999.

Depreciation expense, by segment, was as follows (in thousands):

	U.S. Retail					
Year Ended December 31,	Books, Music and DVD/Video	Electronics, Tools and Kitchen	Total	Services	International	Consolidated
2001	$29,317	$21,670	$50,987	$8,349	$24,108	$83,444
2000	29,501	26,818	56,319	7,649	18,970	82,938
1999	15,304	7,730	23,034	4,873	6,674	34,581

At December 31, 2001 and 2000, fixed assets, net totaled $228 million and $315 million in the United States, respectively, and $44 million and $51 million in other countries, respectively.

Note 17—QUARTERLY RESULTS (unaudited)

The following tables contain selected unaudited statement of operations information for each quarter of 2001, 2000 and 1999. The Company believes that the following information reflects all normal recurring adjustments necessary for a fair presentation of the information for the periods presented. The operating results for any quarter are not necessarily indicative of results for any future period.

	Year Ended December 31, 2001			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(in thousands, except per share data)			
Net sales	$1,115,171	$ 639,281	$ 667,625	$ 700,356
Gross profit	274,049	162,192	179,720	182,597
Net income (loss)	5,087	(169,874)	(168,359)	(234,131)
Basic and diluted income (loss) per share:				
Prior to cumulative effect of change in accounting principle	$ 0.01	$ (0.46)	$ (0.47)	$ (0.63)
Cumulative effect of change in accounting principle	—	—	—	(0.03)
Basic and diluted income (loss) per share (1)	$ 0.01	$ (0.46)	$ (0.47)	$ (0.66)
Shares used in computation of basic income (loss) per share	371,420	368,052	359,752	357,424
Shares used in computation of diluted income (loss) per share	384,045	368,052	359,752	357,424

	Year Ended December 31, 2000			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(in thousands, except per share data)			
Net sales	$ 972,360	$ 637,858	$ 577,876	$ 573,889
Gross profit	224,300	167,279	136,064	128,134
Net loss	(545,140)	(240,524)	(317,184)	(308,425)
Basic and diluted loss per share (1)	$ (1.53)	$ (0.68)	$ (0.91)	$ (0.90)
Shares used in computation of basic and diluted loss per share	355,681	353,954	349,886	343,884

	Year Ended December 31, 1999			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(in thousands, except per share data)			
Net sales	$ 676,042	$ 355,777	$ 314,377	$ 293,643
Gross profit	87,846	70,477	67,531	64,791
Net loss	(323,213)	(197,080)	(138,008)	(61,667)
Basic and diluted loss per share (1)	$ (0.96)	$ (0.59)	$ (0.43)	$ (0.20)
Shares used in computation of basic and diluted loss per share	338,389	332,488	322,340	313,794

(1) The sum of quarterly per share amounts may not equal per share amounts reported for year-to-date periods. This is due to changes in the number of weighted-average shares outstanding and the effects of rounding for each period.

ITEM 9. *Changes in and Disagreements with Accountants On Accounting and Financial Disclosure*

None.

PART III

ITEM 10. *Directors and Executive Officers of the Registrant*

Information regarding our executive officers required by Item 10, Part III, is set forth in Item 1 of Part I herein under the caption "Executive Officers and Directors." Information required by Item 10, Part III, regarding our directors is included in our Proxy Statement relating to our 2002 annual meeting of stockholders, and is incorporated herein by reference. Information relating to compliance with Section 16(a) of the Securities Exchange Act of 1934, as amended, is set forth in the Proxy Statement and incorporated herein by reference.

ITEM 11. *Executive Compensation*

Information required by Item 11, Part III, is included in our Proxy Statement relating to our 2002 annual meeting of stockholders, and is incorporated herein by reference.

ITEM 12. *Security Ownership of Certain Beneficial Owners and Management*

Information required by Item 12, Part III, is included in our Proxy Statement relating to our 2002 annual meeting of stockholders, and is incorporated herein by reference.

ITEM 13. *Certain Relationships and Related Transactions*

Information regarding certain of our relationships and related transactions is included in our Proxy Statement relating to our 2002 annual meeting of stockholders, and is incorporated herein by reference.

PART IV

ITEM 14. *Exhibits, Financial Statement Schedules and Reports on Form 8-K*

(a) *List of Documents Filed as a Part of This Report:*

(1) *Index to Consolidated Financial Statements:*

Report of Ernst & Young LLP, Independent Auditors

Consolidated Balance Sheets as of December 31, 2001 and 2000

Consolidated Statements of Operations for each of the three years ended December 31, 2001

Consolidated Statements of Cash Flows for each of the three years ended December 31, 2001

Consolidated Statements of Stockholders' Equity (Deficit) for each of the three years ended December 31, 2001

Notes to Consolidated Financial Statements

(2) *Index to Financial Statement Schedules:*

Schedule II—Valuation and Qualifying Accounts

All other schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto, or is not applicable or required.

(3) *Index to Exhibits*

Exhibit Number	Description
3.1	Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ending March 31, 2000).
3.2	Restated Bylaws of the Company (incorporated by reference to the Company's Current Report on Form 8-K dated February 28, 2000).
4.1	Indenture, dated as of May 8, 1998, between Amazon.com, Inc. and the Bank of New York, as trustee (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarterly Period Ended March 31, 1998).
4.2	Form of 10% Senior Discount Notes Due 2008 (incorporated by reference to the Company's Registration Statement on Form S-4 (Registration No. 333-56723) filed June 12, 1998).
4.3	Indenture, dated as of February 3, 1999, between Amazon.com, Inc. and The Bank of New York, as trustee, including the form of 4¾% Convertible Subordinated Note Due 2009 attached as Exhibit A thereto (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.4	Registration Rights Agreement by and among Amazon.com, Inc. and the Initial Purchasers (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.5	Indenture, dated as of February 16, 2000, between Amazon.com, Inc. and the Bank of New York, as trustee (incorporated by Reference to the Company's Current Report on Form 8-K dated February 16, 2000).
4.6	Form of 6⅞% Convertible Subordinated Notes due 2010 (incorporated by reference to the Company's Current Report on Form 8-K dated February 28, 2000).
10.1†	Amended and Restated 1994 Stock Option Plan (version as of December 20, 1996 for Amended and Restated Grants and version as of December 20, 1996 for New Grants) (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.2†	1997 Stock Incentive Plan (incorporated by reference to Appendix B to the Company's Proxy Statement on Schedule 14A, filed with the Securities and Exchange Commission on March 29, 2000).
10.3†	1999 Non-Officer Employee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 333-74419) filed March 15, 1999).
10.4†	Accept.com Financial Services Corporation 1998 Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 333-80495) filed June 11, 1999).
10.5†	Form of Indemnification Agreement between the Company and each of its Directors (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.6	Investor Rights Agreement, dated as of June 21, 1996, by and among the Company, Kleiner Perkins Caufield & Byers VIII, KPCB Information Sciences Zaibatsu Fund II and Jeffrey P. Bezos (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.7†	Offer Letter of Employment to Warren C. Jenson dated September 4, 1999, as amended and restated September 30, 1999 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 1999).

Exhibit Number	Description
10.8†	Offer Letter of Employment to Jeff Wilke, dated September 2, 1999 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 1999).
10.9†	Offer Letter of Employment to Diego Piacentini, dated January 17, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.10†	Executive Compensation Letter to Jeff Wilke, dated May 16, 2000 (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000).
10.11†	Executive Compensation Letter to Warren Jenson, dated May 16, 2000 (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000).
10.12†	Executive Compensation Letter to Mark Britto, dated January 3, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.13†	Executive Compensation Letter to Mark Britto, dated July 27, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.14†	Executive Compensation Letter to Diego Piacentini, dated May 16, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.15	Common Stock Purchase Agreement, dated July 23, 2001, between Amazon.com, Inc. and America Online, Inc. (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2001).
10.16†	Form of Restricted Stock Agreement.
12.1	Computation of Ratio of Earnings to Fixed Charges.
18.1	Preferability Letter of Ernst & Young LLP, Independent Auditors, regarding change in accounting principle (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
21.1	List of Subsidiaries.
23.1	Consent of Ernst & Young LLP, Independent Auditors.
99.1	Press Release dated January 22, 2002 Announcing the Company's Fourth Quarter Financial Results.

† Executive Compensation Plan or Agreement

(b) *Reports on Form 8-K:*

None.

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, as of January 24, 2002.

AMAZON.COM, INC.

By: /s/ JEFFREY P. BEZOS

Jeffrey P. Bezos
President, Chief Executive Officer
and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities indicated as of January 24, 2002.

Signature	Title
/s/ JEFFREY P. BEZOS Jeffrey P. Bezos	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
/s/ WARREN C. JENSON Warren C. Jenson	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ TOM A. ALBERG Tom A. Alberg	Director
/s/ SCOTT D. COOK Scott D. Cook	Director
/s/ L. JOHN DOERR L. John Doerr	Director
/s/ MARK S. HANSEN Mark S. Hansen	Director
/s/ PATRICIA Q. STONESIFER Patricia Q. Stonesifer	Director

To our shareholders:

In many ways, Amazon.com is not a normal store. We have deep selection that is unconstrained by shelf space. We turn our inventory 19 times in a year. We personalize the store for each and every customer. We trade real estate for technology (which gets cheaper and more capable every year). We display customer reviews critical of our products. You can make a purchase with a few seconds and one click. We put used products next to new ones so you can choose. We share our prime real estate—our product detail pages—with third parties, and, if they can offer better value, we let them.

One of our most exciting peculiarities is poorly understood. People see that we're determined to offer both world-leading customer experience *and* the lowest possible prices, but to some this dual goal seems paradoxical if not downright quixotic. Traditional stores face a time-tested tradeoff between offering high-touch customer experience on the one hand and the lowest possible prices on the other. How can Amazon.com be trying to do both?

The answer is that we transform much of customer experience—such as unmatched selection, extensive product information, personalized recommendations, and other new software features—into largely a fixed expense. With customer experience costs largely fixed (more like a publishing model than a retailing model), our costs as a percentage of sales can shrink rapidly as we grow our business. Moreover, customer experience costs that remain variable—such as the variable portion of fulfillment costs—improve in our model as we reduce defects. Eliminating defects improves costs and leads to better customer experience.

We believe our ability to lower prices and simultaneously drive customer experience is a big deal, and this past year offers evidence that the strategy is working.

First, we do continue to drive customer experience. The holiday season this year is one example. While delivering a record number of units to customers, we also delivered our best-ever experience. Cycle time, the amount of time taken by our fulfillment centers to process an order, improved 17% compared with last year. And our most sensitive measure of customer satisfaction, contacts per order, saw a 13% improvement.

Inside existing product categories, we've worked hard to increase selection. Electronics selection is up over 40% in the U.S. alone over the prior year, and we now offer 10 times the selection of a typical big box electronics store. Even in U.S. books, where we've been working for 8 years, we increased selection by 15%, mostly in harder-to-find and out-of-print titles. And, of course, we've added new categories. Our Apparel and Accessories store has more than 500 top clothing brands, and in its first 60 days, customers bought 153,000 shirts, 106,000 pairs of pants, and 31,000 pairs of underwear.

In this year's American Customer Satisfaction Index, the most authoritative study of customer satisfaction, Amazon.com scored an 88, the highest score ever recorded—not just online, not just in retailing—but the highest score ever recorded in any service industry. In ACSI's words:

> "Amazon.com continues to show remarkably high levels of customer satisfaction. With a score of 88 (up 5%), it is generating satisfaction at a level unheard of in the service industry…. Can customer satisfaction for Amazon climb more? The latest ACSI data suggest that it is indeed possible. Both service and the value proposition offered by Amazon have increased at a steep rate."

Second, while focused on customer experience, we've also been lowering price substantially. We've been doing so broadly across product categories, from books to electronics, and we've eliminated shipping fees with our 365 day-per-year Free Super Saver Shipping on orders over $25. We've been taking similar actions in every country in which we do business.

Our pricing objective is not to discount a small number of products for a limited period of time, but to offer low prices everyday and apply them broadly across our entire product range. To illustrate this point, we recently did a price comparison versus a major well-known chain of book superstores. We did not hand pick a choice group of books against which we wanted to compare. Instead, we used their published list of their 100 bestsellers for 2002. It was a good representation of the kinds of books people buy most, consisting of 45 hardcover titles and 55 paperbacks across many different categories, including Literature, Romance, Mystery and Thrillers, Nonfiction, Children's, Self-Help, and so on.

We priced all 100 titles by visiting their superstores in both Seattle and New York City. It took us six hours in four of their different superstores to find all 100 books on their list. When we added up everything we spent, we discovered that:

- At their stores, these 100 bestselling books cost $1,561. At Amazon.com, the same books cost $1,195 for a total savings of $366, or 23%.

- For 72 of the 100 books, our price was cheaper. On 25 of the books, our price was the same. On 3 of the 100, their prices were better (we subsequently reduced our prices on these three books).

- In these physical-world superstores, only 15 of their 100 titles were discounted—they were selling the other 85 at full list price. At Amazon.com, 76 of the 100 were discounted and 24 were sold at list price.

To be sure, you may find reasons to shop in the physical world—for instance, if you need something immediately—but, if you do so, you'll be paying a premium. If you want to save money and time, you'll do better by shopping at Amazon.com.

Third, our determination to deliver low price *and* customer experience is generating financial results. Net sales this year increased 26% to a record $3.9 billion, and unit sales grew at an even faster 34%. Free cash flow—our most important financial measure—reached $135 million, a $305 million improvement over the prior year.[1]

In short, what's good for customers is good for shareholders.

Once again this year, I attach a copy of our original 1997 letter and encourage current and prospective shareowners to take a look at it. Given how much we've grown and how much the Internet has evolved, it's notable that the fundamentals of how we do business remain the same.

As always, we at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

[1] Free cash flow for 2002 of $135 million is net cash provided by operating activities of $174 million less purchases of fixed assets of $39 million. Free cash flow for 2001 of negative $170 million is net cash used in operating activities of $120 million less purchases of fixed assets of $50 million.

1997 LETTER TO SHAREHOLDERS
(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.

- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.

- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.

- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.

- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.

- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.

- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click(SM) shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.

- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.

- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.

- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.

- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.

- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.

- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.

- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, “You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

amazon.com

To our shareholders:

Long-term thinking is both a requirement and an outcome of true ownership. Owners are different from tenants. I know of a couple who rented out their house, and the family who moved in nailed their Christmas tree to the hardwood floors instead of using a tree stand. Expedient, I suppose, and admittedly these were particularly bad tenants, but no owner would be so short-sighted. Similarly, many investors are effectively short-term tenants, turning their portfolios so quickly they are really just renting the stocks that they temporarily “own.”

We emphasized our long-term views in our 1997 letter to shareholders, our first as a public company, because that approach really does drive making many concrete, non-abstract decisions. I’d like to discuss a few of these non-abstract decisions in the context of customer experience. At Amazon.com, we use the term customer experience broadly. It includes every customer-facing aspect of our business—from our product prices to our selection, from our website’s user interface to how we package and ship items. The customer experience we create is by far the most important driver of our business.

As we design our customer experience, we do so with long-term owners in mind. We try to make all of our customer experience decisions—big and small—in that framework.

For instance, shortly after launching Amazon.com in 1995, we empowered customers to review products. While now a routine Amazon.com practice, at the time we received complaints from a few vendors, basically wondering if we understood our business: “You make money when you sell things—why would you allow negative reviews on your website?” Speaking as a focus group of one, I know I’ve sometimes changed my mind before making purchases on Amazon.com as a result of negative or lukewarm customer reviews. Though negative reviews cost us some sales in the short term, helping customers make better purchase decisions ultimately pays off for the company.

Another example is our Instant Order Update feature, which reminds you that you’ve already bought a particular item. Customers lead busy lives and cannot always remember if they’ve already purchased a particular item, say a DVD or CD they bought a year earlier. When we launched Instant Order Update, we were able to measure with statistical significance that the feature slightly reduced sales. Good for customers? Definitely. Good for shareowners? Yes, in the long run.

Among the most expensive customer experience improvements we’re focused on are our everyday free-shipping offers and our ongoing product price reductions. Eliminating defects, improving productivity, and passing the resulting cost savings back to customers in the form of lower prices is a long-term decision. Increased volumes take time to materialize, and price reductions almost always hurt current results. In the long term, however, relentlessly driving the “price-cost structure loop” will leave us with a stronger, more valuable business. Since many of our costs, such as software engineering, are relatively fixed and many of our variable costs can also be better managed at larger scale, driving more volume through our cost structure reduces those costs as a percentage of sales. To give one small example, engineering a feature like Instant Order Update for use by 40 million customers costs nowhere near 40 times what it would cost to do the same for 1 million customers.

Our pricing strategy does not attempt to maximize margin *percentages*, but instead seeks to drive maximum value for customers and thereby create a much larger bottom line—in the long term. For example, we’re targeting gross margins on our jewelry sales to be substantially lower than industry norms because we believe over time—customers figure these things out—this approach will produce more value for shareholders.

We have a strong team of hard-working, innovative folks building Amazon.com. They are focused on the customer and focused on the long term. On that time scale, the interests of shareowners and customers are aligned.

As always, I attach our 1997 letter and believe it is still worth a read. Here's to not being a tenant!

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

P.S. Again this year, the widely-followed American Customer Satisfaction Index gave Amazon.com a score of 88—the highest customer satisfaction score ever recorded in any service industry, online or off. A representative of the ACSI was quoted as saying, "If they go any higher, they will get a nose bleed." We're working on that.

amazon.com

1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

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- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

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From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

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- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.

- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

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It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

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We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareholders:

Our ultimate financial measure, and the one we most want to drive over the long-term, is free cash flow per share.

Why not focus first and foremost, as many do, on earnings, earnings per share or earnings growth? The simple answer is that earnings don't directly translate into cash flows, and shares are worth only the present value of their future cash flows, not the present value of their future earnings. Future earnings are a component—but not the only important component—of future cash flow per share. Working capital and capital expenditures are also important, as is future share dilution.

Though some may find it counterintuitive, a company can actually impair shareholder value in certain circumstances by growing earnings. This happens when the capital investments required for growth exceed the present value of the cash flow derived from those investments.

To illustrate with a hypothetical and very simplified example, imagine that an entrepreneur invents a machine that can quickly transport people from one location to another. The machine is expensive—$160 million with an annual capacity of 100,000 passenger trips and a four year useful life. Each trip sells for $1,000 and requires $450 in cost of goods for energy and materials and $50 in labor and other costs.

Continue to imagine that business is booming, with 100,000 trips in Year 1, completely and perfectly utilizing the capacity of one machine. This leads to earnings of $10 million after deducting operating expenses including depreciation—a 10% net margin. The company's primary focus is on earnings; so based on initial results the entrepreneur decides to invest more capital to fuel sales and earnings growth, adding additional machines in Years 2 through 4.

Here are the income statements for the first four years of business:

	Earnings			
	Year 1	Year 2	Year 3	Year 4
	(in thousands)			
Sales	$100,000	$200,000	$400,000	$800,000
Units sold	100	200	400	800
Growth	N/A	100%	100%	100%
Gross profit	55,000	110,000	220,000	440,000
Gross margin	55%	55%	55%	55%
Depreciation	40,000	80,000	160,000	320,000
Labor & other costs	5,000	10,000	20,000	40,000
Earnings	$ 10,000	$ 20,000	$ 40,000	$ 80,000
Margin	10%	10%	10%	10%
Growth	N/A	100%	100%	100%

It's impressive: 100% compound earnings growth and $150 million of cumulative earnings. Investors considering only the above income statement would be delighted.

However, looking at cash flows tells a different story. Over the same four years, the transportation business generates cumulative negative free cash flow of $530 million.

	Cash Flows			
	Year 1	Year 2	Year 3	Year 4
	(in thousands)			
Earnings	$ 10,000	$ 20,000	$ 40,000	$ 80,000
Depreciation	40,000	80,000	160,000	320,000
Working capital	—	—	—	—
Operating Cash Flow	50,000	100,000	200,000	400,000
Capital expenditures	160,000	160,000	320,000	640,000
Free Cash Flow	$(110,000)	$ (60,000)	$(120,000)	$(240,000)

There are of course other business models where earnings more closely approximate cash flows. But as our transportation example illustrates, one cannot assess the creation or destruction of shareholder value with certainty by looking at the income statement alone.

Notice, too, that a focus on EBITDA—Earnings Before Interest, Taxes, Depreciation and Amortization—would lead to the same faulty conclusion about the health of the business. Sequential annual EBITDA would have been $50, $100, $200 and $400 million—100% growth for three straight years. But without taking into account the $1.28 billion in capital expenditures necessary to generate this 'cash flow,' we're getting only part of the story—EBITDA isn't cash flow.

What if we modified the growth rates and, correspondingly, capital expenditures for machinery—would cash flows have deteriorated or improved?

Year 2, 3 and 4 Sales and Earnings Growth Rate	Number of Machines in Year 4	Year 1 to 4 Cumulative Earnings	Year 1 to 4 Cumulative Free Cash Flow
		(in thousands)	
0%, 0%, 0%	1	$ 40,000	$ 40,000
100%, 50%, 33%	4	$100,000	$(140,000)
100%, 100%, 100%	8	$150,000	$(530,000)

Paradoxically, from a cash flow perspective, the slower this business grows the better off it is. Once the initial capital outlay has been made for the first machine, the ideal growth trajectory is to scale to 100% of capacity quickly, then stop growing. However, even with only one piece of machinery, the gross cumulative cash flow doesn't surpass the initial machine cost until Year 4 and the net present value of this stream of cash flows (using 12% cost of capital) is still negative.

Unfortunately our transportation business is fundamentally flawed. There is no growth rate at which it makes sense to invest initial or subsequent capital to operate the business. In fact, our example is so simple and clear as to be obvious. Investors would run a net present value analysis on the economics and quickly determine it doesn't pencil out. Though it's more subtle and complex in the real world, this issue—the duality between earnings and cash flows—comes up all the time.

Cash flow statements often don't receive as much attention as they deserve. Discerning investors don't stop with the income statement.

Our Most Important Financial Measure: Free Cash Flow Per Share

Amazon.com's financial focus is on long-term growth in free cash flow per share.

Amazon.com's free cash flow is driven primarily by increasing operating profit dollars and efficiently managing both working capital and capital expenditures. We work to increase operating profit by focusing on improving all aspects of the customer experience to grow sales and by maintaining a lean cost structure.

We have a cash generative operating cycle[1] because we turn our inventory quickly, collecting payments from our customers before payments are due to suppliers. Our high inventory turnover means we maintain relatively low levels of investment in inventory—$480 million at year end on a sales base of nearly $7 billion.

The capital efficiency of our business model is illustrated by our modest investments in fixed assets, which were $246 million at year end or 4% of 2004 sales.

Free cash flow[2] grew 38% to $477 million in 2004, a $131 million improvement over the prior year. We are confident that if we continue to improve customer experience—including increasing selection and lowering prices—and execute efficiently, our value proposition, as well as our free cash flow, will further expand.

As to dilution, total shares outstanding plus stock-based awards are essentially unchanged at the end of 2004 compared with 2003, and are down 1% over the last three years. During that same period, we've also eliminated over six million shares of potential future dilution by repaying more than $600 million of convertible debt that was due in 2009 and 2010. Efficiently managing share count means more cash flow per share and more long-term value for owners.

This focus on free cash flow isn't new for Amazon.com. We made it clear in our 1997 letter to shareholders—our first as a public company—that when "forced to choose between optimizing GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows." I'm attaching a copy of our complete 1997 letter and encourage current and prospective shareowners to take a look at it.

As always, we at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

April 2005

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1 The operating cycle is number of days of sales in inventory plus number of days of sales in accounts receivable minus accounts payable days.

2 Free cash flow is defined as net cash provided by operating activities less purchases of fixed assets, including capitalized internal-use software and website development, both of which are presented on our statements of cash flows. Free cash flow for 2004 of $477 million is net cash provided by operating activities of $567 million less purchases of fixed assets, including capitalized internal-use software and website development costs, of $89 million. Free cash flow for 2003 of $346 million is net cash provided by operating activities of $392 million less purchases of fixed assets, including capitalized internal-use software and website development costs, of $46 million.

amazon.com

1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click[SM] shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
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To our shareholders:

Many of the important decisions we make at Amazon.com can be made with data. There is a right answer or a wrong answer, a better answer or a worse answer, and math tells us which is which. These are our favorite kinds of decisions.

Opening a new fulfillment center is an example. We use history from our existing fulfillment network to estimate seasonal peaks and to model alternatives for new capacity. We look at anticipated product mix, including product dimensions and weight, to decide how much space we need and whether we need a facility for smaller "sortable" items or for larger items that usually ship alone. To shorten delivery times and reduce outbound transportation costs, we analyze prospective locations based on proximity to customers, transportation hubs, and existing facilities. Quantitative analysis improves the customer's experience and our cost structure.

Similarly, most of our inventory purchase decisions can be numerically modeled and analyzed. We want products in stock and immediately available to customers, and we want minimal total inventory in order to keep associated holding costs, and thus prices, low. To achieve both, there is a right amount of inventory. We use historical purchase data to forecast customer demand for a product and expected variability in that demand. We use data on the historical performance of vendors to estimate replenishment times. We can determine where to stock the product within our fulfillment network based on inbound and outbound transportation costs, storage costs, and anticipated customer locations. With this approach, we keep over one million unique items under our own roof, immediately available for customers, while still turning inventory more than fourteen times per year.

The above decisions require us to make some assumptions and judgments, but in such decisions, judgment and opinion come into play only as junior partners. The heavy lifting is done by the math.

As you would expect, however, not all of our important decisions can be made in this enviable, math-based way. Sometimes we have little or no historical data to guide us and proactive experimentation is impossible, impractical, or tantamount to a decision to proceed. Though data, analysis, and math play a role, the prime ingredient in these decisions is judgment.[1]

As our shareholders know, we have made a decision to continuously and significantly lower prices for customers year after year as our efficiency and scale make it possible. This is an example of a very important decision that cannot be made in a math-based way. In fact, when we lower prices, we go against the math that we can do, which always says that the smart move is to *raise* prices. We have significant data related to price elasticity. With fair accuracy, we can predict that a price reduction of a certain percentage will result in an increase in units sold of a certain percentage. With rare exceptions, the volume increase in the short term is never enough to pay for the price decrease. However, our quantitative understanding of elasticity is short-term. We can estimate what a price reduction will do this week and this quarter. But we cannot numerically estimate the effect that consistently lowering prices will have on our business over five years or ten years or more. Our *judgment* is that relentlessly returning efficiency improvements and scale economies to customers in the form of lower prices

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1 "The Structure of 'Unstructured' Decision Processes" is a fascinating 1976 paper by Henry Mintzberg, Duru Raisinghani, and Andre Theoret. They look at how institutions make strategic, "unstructured" decisions as opposed to more quantifiable "operating" decisions. Among other gems you will find in the paper is this: "Excessive attention by management scientists to operating decisions may well cause organizations to pursue inappropriate courses of action more efficiently." They are not debating the importance of rigorous and quantitative analysis, but only noting that it gets a lopsided amount of study and attention, probably because of the very fact that it is more quantifiable. The whole paper is available at www.amazon.com/ir/mintzberg.

creates a virtuous cycle that leads over the long term to a much larger dollar amount of free cash flow, and thereby to a much more valuable Amazon.com. We've made similar judgments around Free Super Saver Shipping and Amazon Prime, both of which are expensive in the short term and—we believe—important and valuable in the long term.

As another example, in 2000 we invited third parties to compete directly against us on our "prime retail real estate"—our product detail pages. Launching a single detail page for both Amazon retail and third-party items seemed risky. Well-meaning people internally and externally worried it would cannibalize Amazon's retail business, and—as is often the case with consumer-focused innovations—there was no way to prove in advance that it would work. Our buyers pointed out that inviting third parties onto Amazon.com would make inventory forecasting more difficult and that we could get "stuck" with excess inventory if we "lost the detail page" to one of our third-party sellers. However, our judgment was simple. If a third party could offer a better price or better availability on a particular item, then we wanted our customer to get easy access to that offer. Over time, third-party sales have become a successful and significant part of our business. Third-party units have grown from 6% of total units sold in 2000 to 28% in 2005, even as retail revenues have grown three-fold.

Math-based decisions command wide agreement, whereas judgment-based decisions are rightly debated and often controversial, at least until put into practice and demonstrated. Any institution unwilling to endure controversy must limit itself to decisions of the first type. In our view, doing so would not only limit controversy —it would also significantly limit innovation and long-term value creation.

The foundation of our decision-making philosophy was laid out in our 1997 letter to shareholders, a copy of which is attached:

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- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

You can count on us to combine a strong quantitative and analytical culture with a willingness to make bold decisions. As we do so, we'll start with the customer and work backwards. In our judgment, that is the best way to create shareholder value.

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Founder and Chief Executive Officer

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1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareholders:

At Amazon's current scale, planting seeds that will grow into meaningful new businesses takes some discipline, a bit of patience, and a nurturing culture.

Our established businesses are well-rooted young trees. They are growing, enjoy high returns on capital, and operate in very large market segments. These characteristics set a high bar for any new business we would start. Before we invest our shareholders' money in a new business, we must convince ourselves that the new opportunity can generate the returns on capital our investors expected when they invested in Amazon. And we must convince ourselves that the new business can grow to a scale where it can be significant in the context of our overall company.

Furthermore, we must believe that the opportunity is currently underserved and that we have the capabilities needed to bring strong customer-facing differentiation to the marketplace. Without that, it's unlikely we'd get to scale in that new business.

I often get asked, "When are you going to open physical stores?" That's an expansion opportunity we've resisted. It fails all but one of the tests outlined above. The potential size of a network of physical stores is exciting. However: we don't know how to do it with low capital and high returns; physical-world retailing is a cagey and ancient business that's already well served; and we don't have any ideas for how to build a physical world store experience that's meaningfully differentiated for customers.

When you do see us enter new businesses, it's because we believe the above tests have been passed. Our acquisition of Joyo.com is a first step in serving the most populous country in the world. E-commerce in China is still in its early days, and we believe it's an excellent business opportunity. Shoes, apparel, groceries: these are big segments where we have the right skills to invent and grow large-scale, high-return businesses that genuinely improve customer experience.

Fulfillment by Amazon is a set of web services API's that turns our 12 million square foot fulfillment center network into a gigantic and sophisticated computer peripheral. Pay us 45 cents per month per cubic foot of fulfillment center space, and you can stow your products in our network. You make web services calls to alert us to expect inventory to arrive, to tell us to pick and pack one or more items, and to tell us where to ship those items. You never have to talk to us. It's differentiated, can be large, and passes our returns bar.

Amazon Web Services is another example. With AWS, we're building a new business focused on a new customer set … software developers. We currently offer ten different web services and have built a community of over 240,000 registered developers. We're targeting broad needs universally faced by developers, such as storage and compute capacity—areas in which developers have asked for help, and in which we have deep expertise from scaling Amazon.com over the last twelve years. We're well positioned to do it, it's highly differentiated, and it can be a significant, financially attractive business over time.

In some large companies, it might be difficult to grow new businesses from tiny seeds because of the patience and nurturing required. In my view, Amazon's culture is unusually supportive of small businesses with big potential, and I believe that's a source of competitive advantage.

Like any company, we have a corporate culture formed not only by our intentions but also as a result of our history. For Amazon, that history is fairly fresh and, fortunately, it includes several examples of tiny seeds growing into big trees. We have many people at our company who have watched multiple $10 million seeds turn into billion dollar businesses. That first-hand experience and the culture that has grown up around those successes is, in my opinion, a big part of why we can start businesses from scratch. The culture demands that these new businesses be high potential and that they be innovative and differentiated, but it does not demand that they be large on the day that they are born.

I remember how excited we were in 1996 as we crossed $10 million in book sales. It wasn't hard to be excited—we had grown to $10 million from zero. Today, when a new business inside Amazon grows to $10 million, the overall company is growing from $10 billion to $10.01 billion. It would be easy for the senior executives who run our established billion dollar businesses to scoff. But they don't. They watch the growth rates of the emerging businesses and send emails of congratulations. That's pretty cool, and we're proud it's a part of our culture.

In our experience, if a new business enjoys runaway success, it can only *begin* to be meaningful to the overall company economics in something like three to seven years. We've seen those time frames with our international businesses, our earlier non-media businesses, and our third party seller businesses. Today, international is 45% of sales, non-media is 34% of sales, and our third party seller businesses account for 28% of our units sold. We will be happy indeed if some of the new seeds we're planting enjoy similar successes.

We've come a distance since we celebrated our first $10 million in sales. As we continue to grow, we'll work to maintain a culture that embraces new businesses. We will do so in a disciplined way, with an eye on returns, potential size, and the ability to create differentiation that customers care about. We won't always choose right, and we won't always succeed. But we will be choosy, and we will work hard and patiently.

As always, I attach our 1997 letter to shareholders. You'll see that our philosophy and approach have not changed. Many thanks for your support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

amazon.com

1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

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To our shareowners:

November 19, 2007, was a special day. After three years of work, we introduced Amazon Kindle to our customers.

Many of you may already know something of Kindle—we're fortunate (and grateful) that it has been broadly written and talked about. Briefly, Kindle is a purpose-built reading device with wireless access to more than 110,000 books, blogs, magazines, and newspapers. The wireless connectivity isn't WiFi—instead it uses the same wireless network as advanced cell phones, which means it works when you're at home in bed or out and moving around. You can buy a book directly from the device, and the whole book will be downloaded wirelessly, ready for reading, in less than 60 seconds. There is no "wireless plan," no year-long contract you must commit to, and no monthly service fee. It has a paper-like electronic-ink display that's easy to read even in bright daylight. Folks who see the display for the first time do a double-take. It's thinner and lighter than a paperback, and can hold 200 books. Take a look at the Kindle detail page on Amazon.com to see what customers think—Kindle has already been reviewed more than 2,000 times.

As you might expect after three years of work, we had sincere hopes that Kindle would be well received, but we did not expect the level of demand that actually materialized. We sold out in the first 5½ hours, and our supply chain and manufacturing teams have had to scramble to increase production capacity.

We started by setting ourselves the admittedly audacious goal of improving upon the physical book. We did not choose that goal lightly. Anything that has persisted in roughly the same form and resisted change for 500 years is unlikely to be improved easily. At the beginning of our design process, we identified what we believe is the book's most important feature. It *disappears*. When you read a book, you don't notice the paper and the ink and the glue and the stitching. All of that dissolves, and what remains is the author's world.

We knew Kindle would have to *get out of the way*, just like a physical book, so readers could become engrossed in the words and forget they're reading on a device. We also knew we shouldn't try to copy every last feature of a book—we could never out-book the book. We'd have to add *new* capabilities—ones that could never be possible with a traditional book.

The early days of Amazon.com provide an analog. It was tempting back then to believe that an online bookstore should have all the features of a physical bookstore. I was asked about a particular feature dozens of times: "How are you going to do electronic book signings?" Thirteen years later, we still haven't figured that one out! Instead of trying to duplicate physical bookstores, we've been inspired by them and worked to find things we could do in the new medium that could never be done in the old one. We don't have electronic book signings, and similarly we can't provide a comfortable spot to sip coffee and relax. However, we can offer literally *millions* of titles, help with purchase decisions through customer reviews, and provide discovery features like "customers who bought this item also bought." The list of useful things that can be done only in the new medium is a long one.

I'll highlight a few of the useful features we built into Kindle that go beyond what you could ever do with a physical book. If you come across a word you don't recognize, you can look it up easily. You can search your books. Your margin notes and underlinings are stored on the server-side in the "cloud," where they can't be lost. Kindle keeps your place in each of the books you're reading, automatically. If your eyes are tired, you can change the font size. Most important is the seamless, simple ability to find a book and have it in 60 seconds. When I've watched people do this for the first time, it's clear the capability has a profound effect on them. Our vision for Kindle is every book ever printed in any language, all available in less than 60 seconds.

Publishers—including all the major publishers—have embraced Kindle, and we're thankful for that. From a publisher's point of view, there are a lot of advantages to Kindle. Books never go out of print, and they never go out of stock. Nor is there ever waste from over-printing. Most important, Kindle makes it more convenient for readers to buy more books. Anytime you make something simpler and lower friction, you get more of it.

We humans co-evolve with our tools. We change our tools, and then our tools change us. Writing, invented thousands of years ago, is a grand whopper of a tool, and I have no doubt that it changed us dramatically. Five hundred years ago, Gutenberg's invention led to a significant step-change in the cost of books. Physical books ushered in a new way of collaborating and learning. Lately, networked tools such as desktop computers, laptops, cell phones and PDAs have changed us too. They've shifted us more toward *information snacking,* and I would argue toward shorter attention spans. I value my BlackBerry—I'm convinced it makes me more productive—but I don't want to read a three-hundred-page document on it. Nor do I want to read something hundreds of pages long on my desktop computer or my laptop. As I've already mentioned in this letter, people do more of what's convenient and friction-free. If our tools make information snacking easier, we'll shift more toward information snacking and away from long-form reading. Kindle is purpose-built for long-form reading. We hope Kindle and its successors may gradually and incrementally move us over years into a world with longer spans of attention, providing a counterbalance to the recent proliferation of info-snacking tools. I realize my tone here tends toward the missionary, and I can assure you it's heartfelt. It's also not unique to me but is shared by a large group of folks here. I'm glad about that because missionaries build better products. I'll also point out that, while I'm convinced books are on the verge of being improved upon, Amazon has no sinecure as that agent. It will happen, but if we don't execute well, it will be done by others.

Your team of missionaries here is fervent about driving free cash flow per share and returns on capital. We know we can do that by putting customers first. I guarantee you there is more innovation ahead of us than behind us, and we do not expect the road to be an easy one. We're hopeful, and I'd even say optimistic, that Kindle, true to its name, will "start a fire" and improve the world of reading.

As always, I attach our 1997 letter to shareholders. You'll see that Kindle exemplifies our philosophy and long-term investment approach as discussed in that letter. Happy reading and many thanks!

Jeff P. Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

April 2008

amazon.com

1997 LETTER TO SHAREHOLDERS
(Reprinted from the 1997 Annual Report)

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Jeff P. Bezos

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Founder and Chief Executive Officer
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To our shareowners:

In this turbulent global economy, our fundamental approach remains the same. Stay heads down, focused on the long term and obsessed over customers. Long-term thinking levers our existing abilities and lets us do new things we couldn't otherwise contemplate. It supports the failure and iteration required for invention, and it frees us to pioneer in unexplored spaces. Seek instant gratification – or the elusive promise of it – and chances are you'll find a crowd there ahead of you. Long-term orientation interacts well with customer obsession. If we can identify a customer need and if we can further develop conviction that that need is meaningful and durable, our approach permits us to work patiently for multiple years to deliver a solution. "Working backwards" from customer needs can be contrasted with a "skills-forward" approach where existing skills and competencies are used to drive business opportunities. The skills-forward approach says, "We are really good at X. What else can we do with X?" That's a useful and rewarding business approach. However, if used exclusively, the company employing it will never be driven to develop fresh skills. Eventually the existing skills will become outmoded. Working backwards from customer needs often *demands* that we acquire new competencies and exercise new muscles, never mind how uncomfortable and awkward-feeling those first steps might be.

Kindle is a good example of our fundamental approach. More than four years ago, we began with a long-term vision: every book, ever printed, in any language, all available in less than 60 seconds. The customer experience we envisioned didn't allow for any hard lines of demarcation between Kindle the device and Kindle the service – the two had to blend together seamlessly. Amazon had never designed or built a hardware device, but rather than change the vision to accommodate our then-existing skills, we hired a number of talented (and missionary!) hardware engineers and got started learning a new institutional skill, one that we needed to better serve readers in the future.

We're grateful and excited that Kindle sales have exceeded our most optimistic expectations. On February 23, we began shipping Kindle 2. If you haven't seen it, Kindle 2 is everything customers loved about the original Kindle, only thinner, faster, with a crisper display, and longer battery life, and capable of holding 1,500 books. You can choose from more than 250,000 of the most popular books, magazines, and newspapers. Wireless delivery is free, and you'll have your book in less than 60 seconds. We've received thousands of feedback emails from customers about Kindle, and – remarkably – 26% of them contain the word "love."

Customer Experience Pillars

In our retail business, we have strong conviction that customers value low prices, vast selection, and fast, convenient delivery and that these needs will remain stable over time. It is difficult for us to imagine that ten years from now, customers will want higher prices, less selection, or slower delivery. Our belief in the durability of these pillars is what gives us the confidence required to invest in strengthening them. We know that the energy we put in now will continue to pay dividends well into the future.

Our pricing objective is to earn customer trust, not to optimize short-term profit dollars. We take it as an article of faith that pricing in this manner is the best way to grow our aggregate profit dollars over the long term. We may make less per item, but by consistently earning trust we will sell many more items. Therefore, we offer low prices across our entire product range. For the same reason, we continue to invest in our free shipping programs, including Amazon Prime. Customers are well-informed and smart, and they evaluate the total cost, including delivery charges, when making their purchasing decisions. In the last 12 months, customers worldwide have saved more than $800 million by taking advantage of our free shipping offers.

We're relentlessly focused on adding selection, both by increasing selection inside existing categories and by adding new categories. We've added 28 new categories since 2007. One business that is rapidly growing and continues to surprise me is our shoe store, Endless.com, which we launched in 2007.

Fast, reliable delivery is important to customers. In 2005, we launched Amazon Prime. For $79 per year,[1] Prime members get unlimited express two-day shipping for free and upgrades to one-day delivery for just $3.99. In 2007, we launched Fulfillment by Amazon, a new service for third-party sellers. With FBA, sellers warehouse their inventory in our global fulfillment network, and we pick, pack, and ship to the end customer on the sellers' behalf. FBA items are eligible for Amazon Prime and Super Saver Shipping – just as if the items were Amazon-owned inventory. As a result, FBA both improves the customer experience and drives seller sales. In the fourth quarter of 2008, we shipped more than 3 million units on behalf of sellers who use Fulfillment by Amazon, a win-win for customers and sellers.

Prudent Spending

The customer-experience path we've chosen requires us to have an efficient cost structure. The good news for shareowners is that we see much opportunity for improvement in that regard. Everywhere we look (and we all look), we find what experienced Japanese manufacturers would call "muda" or waste.[2] I find this incredibly energizing. I see it as potential – years and years of variable and fixed productivity gains and more efficient, higher velocity, more flexible capital expenditures.

Our primary financial goal remains maximizing long-term free cash flow and doing so with high rates of return on invested capital. We are investing heartily in Amazon Web Services, in tools for third-party sellers, in digital media, in China, and in new product categories. And we make these investments with the belief that they can be of meaningful scale and can clear our high bar for returns.

Around the world, amazing, inventive, and hard-working Amazonians are putting customers first. I take great pride in being part of this team. We thank you, our owners, for your support, for your encouragement, and for joining us on our continuing adventure.

As always, I attach our 1997 letter to shareowners. Even as the rate of change accelerates, we hope and believe our focus on what stays the same should serve us well.

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

April 2009

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1 Prime is a global program. ¥3,900 in Japan, £48 in the UK, €29 in Germany, and €49 in France.

2 At a fulfillment center recently, one of our Kaizen experts asked me, "I'm in favor of a clean fulfillment center, but why are you cleaning? Why don't you eliminate the source of dirt?" I felt like the Karate Kid.

amazon.com

1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

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Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

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- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
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To our shareowners:

The financial results for 2009 reflect the cumulative effect of 15 years of customer experience improvements: increasing selection, speeding delivery, reducing cost structure so we can afford to offer customers ever-lower prices, and many others. This work has been done by a large number of smart, relentless, customer-devoted people across all areas of the company. We are proud of our low prices, our reliable delivery, and our in-stock position on even obscure and hard-to-find items. We also know that we can still be much better, and we're dedicated to improving further.

Some notable highlights from 2009:

- Net sales increased 28% year-over-year to $24.51 billion in 2009. This is 15 times higher than net sales 10 years ago when they were $1.64 billion in 1999.
- Free cash flow increased 114% year-over-year to $2.92 billion in 2009.
- More customers are taking advantage of Amazon Prime, with worldwide memberships up significantly over last year. The number of different items available for immediate shipment grew more than 50% in 2009.
- We added 21 new product categories around the world in 2009, including Automotive in Japan, Baby in France, and Shoes and Apparel in China.
- It was a busy year for our shoes business. In November we acquired Zappos, a leader in online apparel and footwear sales that strives to provide shoppers with the best possible service and selection. Zappos is a terrific addition to our Endless, Javari, Amazon, and Shopbop selection.
- The apparel team continued to enhance customer experience with the launch of our Denim Shop offering 100 brands, including Joe's Jeans, Lucky Brand, 7 For All Mankind, and Levi's.
- The shoes and apparel teams created over 121,000 product descriptions and uploaded over 2.2 million images to the website providing customers with a vivid shopping experience.
- Approximately 7 million customer reviews were added to websites worldwide.
- Sales of products by third party sellers on our websites represented 30% of unit sales in 2009. Active seller accounts increased 24% to 1.9 million for the year. Globally, sellers using Fulfillment By Amazon stowed more than one million unique items in our fulfillment center network, thereby making these items available for Free Super Saver Shipping and Amazon Prime.
- Amazon Web Services continued its rapid pace of innovation, launching many new services and features, including the Amazon Relational Database Service, Virtual Private Cloud, Elastic MapReduce, High-Memory EC2 Instances, Reserved and Spot Instances, Streaming for Amazon CloudFront, and Versioning for Amazon S3. AWS also continued to expand its global footprint to include additional services in the EU, a new Northern California Region and plans for a presence in the Asia-Pacific Region in 2010. The continued innovation and track record for operational performance helped AWS add more customers in 2009 than ever before, including many large enterprise customers.
- The U.S. Kindle Store now has more than 460,000 books, an increase from 250,000 last year, and includes 103 of the 110 New York Times Bestsellers, more than 8,900 blogs, and 171 top U.S. and International newspapers and magazines. We have shipped Kindles to more than 120 countries, and we now provide content in six different languages.

Senior leaders that are new to Amazon are often surprised by how little time we spend discussing actual financial results or debating projected financial outputs. To be clear, we take these financial outputs seriously, but we believe that focusing our energy on the controllable inputs to our business is the most effective way to maximize financial outputs over time. Our annual goal setting process begins in the fall, and concludes early in the new year after we've completed our peak holiday quarter. Our goal setting sessions are lengthy, spirited, and detail-oriented. We have a high bar for the experience our customers deserve and a sense of urgency to improve that experience.

We've been using this same annual process for many years. For 2010, we have 452 detailed goals with owners, deliverables, and targeted completion dates. These are not the only goals our teams set for themselves, but they are the ones we feel are most important to monitor. None of these goals are easy and many will not be achieved without invention. We review the status of each of these goals several times per year among our senior leadership team and add, remove, and modify goals as we proceed.

A review of our current goals reveals some interesting statistics:

- 360 of the 452 goals will have a direct impact on customer experience.
- The word *revenue* is used eight times and *free cash flow* is used only four times.
- In the 452 goals, the terms *net income*, *gross profit* or *margin*, and *operating profit* are not used once.

Taken as a whole, the set of goals is indicative of our fundamental approach. Start with customers, and work backwards. Listen to customers, but don't *just* listen to customers – also invent on their behalf. We can't assure you that we'll meet all of this year's goals. We haven't in past years. However, we can assure you that we'll continue to obsess over customers. We have strong conviction that that approach – in the long term – is every bit as good for owners as it is for customers.

As always, I attach a copy of our original 1997 letter. Our approach remains the same, and it's still Day 1.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.
April 2010

amazon.com

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To our shareowners:

Random forests, naïve Bayesian estimators, RESTful services, gossip protocols, eventual consistency, data sharding, anti-entropy, Byzantine quorum, erasure coding, vector clocks … walk into certain Amazon meetings, and you may momentarily think you've stumbled into a computer science lecture.

Look inside a current textbook on software architecture, and you'll find few patterns that we don't apply at Amazon. We use high-performance transactions systems, complex rendering and object caching, workflow and queuing systems, business intelligence and data analytics, machine learning and pattern recognition, neural networks and probabilistic decision making, and a wide variety of other techniques. And while many of our systems are based on the latest in computer science research, this often hasn't been sufficient: our architects and engineers have had to advance research in directions that no academic had yet taken. Many of the problems we face have no textbook solutions, and so we -- happily -- invent new approaches.

Our technologies are almost exclusively implemented as *services*: bits of logic that encapsulate the data they operate on and provide hardened interfaces as the only way to access their functionality. This approach reduces side effects and allows services to evolve at their own pace without impacting the other components of the overall system. Service-oriented architecture -- or SOA -- is the fundamental building abstraction for Amazon technologies. Thanks to a thoughtful and far-sighted team of engineers and architects, this approach was applied at Amazon long before SOA became a buzzword in the industry. Our e-commerce platform is composed of a federation of hundreds of software services that work in concert to deliver functionality ranging from recommendations to order fulfillment to inventory tracking. For example, to construct a product detail page for a customer visiting Amazon.com, our software calls on between 200 and 300 services to present a highly personalized experience for that customer.

State management is the heart of any system that needs to grow to very large size. Many years ago, Amazon's requirements reached a point where many of our systems could no longer be served by any commercial solution: our key data services store many petabytes of data and handle millions of requests per second. To meet these demanding and unusual requirements, we've developed several alternative, purpose-built persistence solutions, including our own key-value store and single table store. To do so, we've leaned heavily on the core principles from the distributed systems and database research communities and invented from there. The storage systems we've pioneered demonstrate extreme scalability while maintaining tight control over performance, availability, and cost. To achieve their ultra-scale properties these systems take a novel approach to data update management: by relaxing the synchronization requirements of updates that need to be disseminated to large numbers of replicas, these systems are able to survive under the harshest performance and availability conditions. These implementations are based on the concept of eventual consistency. The advances in data management developed by Amazon engineers have been the starting point for the architectures underneath the cloud storage and data management services offered by Amazon Web Services (AWS). For example, our Simple Storage Service, Elastic Block Store, and SimpleDB all derive their basic architecture from unique Amazon technologies.

Other areas of Amazon's business face similarly complex data processing and decision problems, such as product data ingestion and categorization, demand forecasting, inventory allocation, and fraud detection. Rule-based systems can be used successfully, but they can be hard to maintain and can become brittle over time. In many cases, advanced machine learning techniques provide more accurate classification and can self-heal to adapt to changing conditions. For example, our search engine employs data mining and machine learning algorithms that run in the background to build topic models, and we apply information extraction algorithms to identify attributes and extract entities from unstructured descriptions, allowing customers to narrow their searches and quickly find the desired product. We consider a large number of factors in search relevance to predict the probability of a customer's interest and optimize the ranking of results. The diversity of products demands that we employ modern regression techniques like trained random forests of decision trees to flexibly incorporate thousands of product attributes at rank time. The end result of all this behind-the-scenes software? Fast, accurate search results that help you find what you want.

All the effort we put into technology might not matter that much if we kept technology off to the side in some sort of R&D department, but we don't take that approach. Technology infuses all of our teams, all of our processes, our decision-making, and our approach to innovation in each of our businesses. It is deeply integrated into everything we do.

One example is Whispersync, our Kindle service designed to ensure that everywhere you go, no matter what devices you have with you, you can access your reading library and all of your highlights, notes, and bookmarks, all in sync across your Kindle devices and mobile apps. The technical challenge is making this a reality for millions of Kindle owners, with hundreds of millions of books, and hundreds of device types, living in over 100 countries around the world—at 24x7 reliability. At the heart of Whispersync is an eventually consistent replicated data store, with application defined conflict resolution that must and can deal with device isolation lasting weeks or longer. As a Kindle customer, of course, we hide all this technology from you. So when you open your Kindle, it's in sync and on the right page. To paraphrase Arthur C. Clarke, like any sufficiently advanced technology, it's indistinguishable from magic.

Now, if the eyes of some shareowners dutifully reading this letter are by this point glazing over, I will awaken you by pointing out that, in my opinion, these techniques are not idly pursued – they lead directly to free cash flow.

We live in an era of extraordinary increases in available bandwidth, disk space, and processing power, all of which continue to get cheap fast. We have on our team some of the most sophisticated technologists in the world – helping to solve challenges that are right on the edge of what's possible today. As I've discussed many times before, we have unshakeable conviction that the long-term interests of shareowners are perfectly aligned with the interests of customers.

And we like it that way. Invention is in our DNA and technology is the fundamental tool we wield to evolve and improve every aspect of the experience we provide our customers. We still have a lot to learn, and I expect and hope we'll continue to have so much fun learning it. I take great pride in being part of this team.

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We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeff P. Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareowners:

The Power of Invention

"To us, the value of Amazon Web Services is undeniable – in twenty seconds, we can double our server capacity. In a high-growth environment like ours and with a small team of developers, it's very important for us to trust that we have the best support to give to the music community around the world. Five years ago, we would have crashed and been down without knowing when we would be back. Now, because of Amazon's continued innovation, we can provide the best technology and continue to grow." That's Christopher Tholen, the Chief Technology Officer of BandPage. His comments about how AWS helps with the critical need to scale compute capacity quickly and reliably are not hypothetical: BandPage now helps 500,000 bands and artists connect with tens of millions of fans.

"So, I started selling on Amazon in April of 2011, and by the time we became the top Amazon lunchbox seller in June, we had between 50 and 75 orders a day. When we hit August and September – our busiest time, with the start of the school year – we had 300, sometimes 500 orders a day. It was just phenomenal… I'm using Amazon to fulfill my orders, which makes my life easier. Plus, when my customers found out they could get free shipping with Prime subscriptions, the lunchboxes began selling like crazy." Kelly Lester is the "mom entrepreneur" of EasyLunchboxes, her own innovative line of easy-to-pack, environmentally friendly lunchbox containers.

"I sort of stumbled onto it, and it opened a whole new world for me. Since I had over a thousand [book] titles at my house, I thought, 'I'll give this a try.' I sold some and I kept expanding it and expanding it, and come to find out this was so much fun I decided I don't ever want to get another job again. And I've got no boss – other than my wife, that is. What could be better than that? We actually work together on this. We both go out hunting, so it's a team effort that's worked out very well. We sell about 700 books a month. We ship between 800 and 900 to Amazon each month and Amazon ships out the 700 that people buy. Without Amazon handling shipping and customer service, my wife and I would have to be running to the post office or someplace every day with dozens of packages. With that part taken care of for us, life is much simpler… This is a terrific program and I love it. After all, Amazon supplies the customers and even ships the books. I mean, how can it get better than that?" Bob Frank founded RJF Books and More after getting laid off in the midst of the economic downturn. He and his wife split their time between Phoenix and Minneapolis, and he describes finding the books he sells like "a treasure hunt every day."

"Because of Kindle Direct Publishing, I earn more royalties in one month than I ever did in a year of writing for a traditional house. I have gone from worrying about if I will be able to pay the bills – and there were many months when I couldn't – to finally having real savings, even thinking about a vacation; something I haven't done in years… Amazon has allowed me to really spread my wings. Prior, I was boxed into a genre, yet I had all of these other books I wanted to write. Now I can do just that. I manage my career. I feel as if I finally have a partner in Amazon. They understand this business and have changed the face of publishing for the good of the writer and the reader, putting choices back into our hands." That's A. K. Alexander, author of *Daddy's Home*, one of the top 100 best-selling Kindle books in March.

"I had no idea that March of 2010, the first month I decided to publish on KDP, would be a defining moment in my life. Within a year of doing so, I was making enough on a monthly basis to quit my day job and focus on writing full time! The rewards that have sprung out of deciding to publish through KDP have been nothing short of life changing. Financially. Personally. Emotionally. Creatively. The ability to write full time, to be home with my family, and to write exactly what I want without the input of a legacy publisher marketing committee wanting to have a say in every detail of my writing, has made me a stronger writer, a more prolific writer, and most importantly a far happier one…. Amazon and KDP are literally enabling creativity in the publishing world and giving writers like me a shot at their dream, and for that I am forever grateful." That's Blake Crouch, author of several thrillers, including the Kindle best seller *Run.*

"Amazon has made it possible for authors like me to get their work in front of readers and has changed my life. In a little over a year, I have sold nearly 250,000 books through the Kindle and have traded in old dreams for bigger and better ones. Four of my books have hit the Top 100 Kindle Best Sellers List. Also, I have been approached by agents, foreign sales people, and two movie producers, and have received mentions in the LA Times, Wall Street Journal, and PC Magazine, and was recently interviewed by USA Today. Mostly, I am excited that all writers now have the opportunity to get their work in front of readers without jumping through insurmountable hoops. Writers have more options and readers have more choices. The publishing world is changing fast, and I plan to enjoy every minute of the ride." Theresa Ragan is the KDP author of multiple Kindle best sellers including *Abducted*.

"Past age 60 and in the midst of the recession, my wife and I found our income options severely limited. KDP was my one shot at a lifelong dream – our only chance at financial salvation. Within months of publishing, KDP has completely changed our lives, enabling this aging nonfiction writer to launch a brand-new career as a best-selling novelist. I can't say enough on behalf of Amazon and the many tools that they make available to independent authors. Without reservation, I urge fellow writers to investigate and seize the opportunities that KDP offers. As I've happily discovered, there is zero downside risk – and the potential is virtually unlimited." Robert Bidinotto is the author of the Kindle best seller *Hunter: A Thriller*.

"I leveraged KDP's technology to blow through all the traditional gatekeepers. Can you imagine how that feels, after struggling so hard, for so long, for every … single … reader? Now, inspirational fiction lovers I never would have reached are enjoying *Nobody* and my other two novels from the Kindle Store at $2.99. I've always wanted to write a Cinderella story. Now I have. And, thanks to Prince Charming (KDP), there will be more to come…" Creston Mapes is the author of the Kindle best seller *Nobody*.

Invention comes in many forms and at many scales. The most radical and transformative of inventions are often those that empower *others* to unleash *their* creativity – to pursue *their* dreams. That's a big part of what's going on with Amazon Web Services, Fulfillment by Amazon, and Kindle Direct Publishing. With AWS, FBA, and KDP, we are creating powerful self-service platforms that allow thousands of people to boldly experiment and accomplish things that would otherwise be impossible or impractical. These innovative, large-scale platforms are not zero-sum – they create win-win situations and create significant value for developers, entrepreneurs, customers, authors, and readers.

Amazon Web Services has grown to have thirty different services and thousands of large and small businesses and individual developers as customers. One of the first AWS offerings, the Simple Storage Service, or S3, now holds over 900 billion data objects, with more than a billion new objects being added every day. S3 routinely handles more than 500,000 transactions per second and has peaked at close to a million transactions per second. All AWS services are pay-as-you-go and radically transform capital expense into a variable cost. AWS is self-service: you don't need to negotiate a contract or engage with a salesperson – you can just read the online documentation and get started. AWS services are elastic – they easily scale up and easily scale down.

In just the last quarter of 2011, Fulfillment by Amazon shipped tens of millions of items on behalf of sellers. When sellers use FBA, their items become eligible for Amazon Prime, for Super Saver Shipping, and for Amazon returns processing and customer service. FBA is self-service and comes with an easy-to-use inventory management console as part of Amazon Seller Central. For the more technically inclined, it also comes with a set of APIs so that you can use our global fulfillment center network like a giant computer peripheral.

I am emphasizing the self-service nature of these platforms because it's important for a reason I think is somewhat non-obvious: even well-meaning gatekeepers slow innovation. When a platform is self-service, even the improbable ideas can get tried, because there's no expert gatekeeper ready to say "that will never work!" And guess what – many of those improbable ideas do work, and society is the beneficiary of that diversity.

Kindle Direct Publishing has quickly taken on astonishing scale – more than a thousand KDP authors now each sell more than a thousand copies a month, some have already reached hundreds of thousands of sales, and two have already joined the Kindle Million Club. KDP is a big win for authors. Authors who use KDP get to keep their copyrights, keep their derivative rights, get to publish on their schedule – a typical delay in traditional publishing can be a year or more from the time the book is finished – and … saving the best for last … KDP authors can get paid royalties of 70%. The largest traditional publishers pay royalties of only 17.5% on ebooks (they pay 25% of 70% of the selling price which works out to be 17.5% of the selling price). The KDP royalty structure is completely transformative for authors. A typical selling price for a KDP book is a reader-friendly $2.99 – authors get approximately $2 of that! With the legacy royalty of 17.5%, the selling price would have to be $11.43 to yield the same $2 per unit royalty. I assure you that authors sell many, many more copies at $2.99 than they would at $11.43.

Kindle Direct Publishing is good for readers because they get lower prices, but perhaps just as important, readers also get access to more diversity since authors that might have been rejected by establishment publishing channels now get their chance in the marketplace. You can get a pretty good window into this. Take a look at the Kindle best-seller list, and compare it to the New York Times best-seller list – which is more diverse? The Kindle list is chock-full of books from small presses and self-published authors, while the New York Times list is dominated by successful and established authors.

Amazonians are leaning into the future, with radical and transformational innovations that create value for thousands of authors, entrepreneurs, and developers. Invention has become second nature at Amazon, and in my view the team's pace of innovation is even accelerating – I can assure you it's very energizing. I'm extremely proud of the whole team, and feel lucky to have a front row seat.

As always, I attach a copy of our original 1997 letter. Our approach remains the same, and it's still Day 1!

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

amazon.com

1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

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- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

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Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
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The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

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Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareowners:

As regular readers of this letter will know, our energy at Amazon comes from the desire to impress customers rather than the zeal to best competitors. We don't take a view on which of these approaches is more likely to maximize business success. There are pros and cons to both and many examples of highly successful competitor-focused companies. We do work to pay attention to competitors and be inspired by them, but it is a fact that the customer-centric way is at this point a defining element of our culture.

One advantage – perhaps a somewhat subtle one – of a customer-driven focus is that it aids a certain type of proactivity. When we're at our best, we don't wait for external pressures. We are *internally* driven to improve our services, adding benefits and features, before we have to. We lower prices and increase value for customers before we have to. We invent before we have to. These investments are motivated by customer focus rather than by reaction to competition. We think this approach earns more trust with customers and drives rapid improvements in customer experience – importantly – even in those areas where we are already the leader.

"Thank you. Every time I see that white paper on the front page of Amazon, I know that I'm about to get more for my money than I thought I would. I signed up for Prime for the shipping, yet now I get movies, and TV and books. You keep adding more, but not charging more. So thanks again for the additions." We now have more than 15 million items in Prime, up 15x since we launched in 2005. Prime Instant Video selection tripled in just over a year to more than 38,000 movies and TV episodes. The Kindle Owners' Lending Library has also more than tripled to over 300,000 books, including an investment of millions of dollars to make the entire *Harry Potter* series available as part of that selection. We didn't "have to" make these improvements in Prime. We did so proactively. A related investment – a major, multi-year one – is Fulfillment by Amazon. FBA gives third-party sellers the option of warehousing their inventory alongside ours in our fulfillment center network. It has been a game changer for our seller customers because their items become eligible for Prime benefits, which drives their sales, while at the same time benefitting consumers with additional Prime selection.

We build automated systems that look for occasions when we've provided a customer experience that isn't up to our standards, and those systems then proactively refund customers. One industry observer recently received an automated email from us that said, "We noticed that you experienced poor video playback while watching the following rental on Amazon Video On Demand: Casablanca. We're sorry for the inconvenience and have issued you a refund for the following amount: $2.99. We hope to see you again soon." Surprised by the proactive refund, he ended up writing about the experience: "Amazon 'noticed that I experienced poor video playback…' And they decided to give me a refund because of that? Wow…Talk about putting customers first."

When you pre-order something from Amazon, we guarantee you the lowest price offered by us between your order time and the end of the day of the release date. "I just received notice of a $5 refund to my credit card for pre-order price protection. . . What a great way to do business! Thank you very much for your fair and honest dealings." Most customers are too busy themselves to monitor the price of an item after they pre-order it, and our policy could be to require the customer to contact us and ask for the refund. Doing it proactively is more expensive for us, but it also surprises, delights, and earns trust.

We also have authors as customers. Amazon Publishing has just announced it will start paying authors their royalties monthly, sixty days in arrears. The industry standard is twice a year, and that has been the standard for a long time. Yet when we interview authors as customers, infrequent payment is a major dissatisfier. Imagine how you'd like it if you were paid twice a year. There isn't competitive pressure to pay authors more than once every six months, but we're proactively doing so. By the way – though the research was taxing, I struggled through and am happy to report that I recently saw many Kindles in use at a Florida beach. There are five generations of Kindle, and I believe I saw every generation in use except for the first. Our business approach is to sell premium hardware at roughly breakeven prices. We want to make money when people use our devices – not when people buy our devices. We think this aligns us better with customers. For example, we don't need our customers to be on the upgrade treadmill. We can be very happy to see people still using four-year-old Kindles!

I can keep going – Kindle Fire's FreeTime, our customer service Andon Cord, Amazon MP3's AutoRip – but will finish up with a very clear example of internally driven motivation: Amazon Web Services. In 2012, AWS announced 159 new features and services. We've reduced AWS prices 27 times since launching 7 years ago, added enterprise service support enhancements, and created innovative tools to help customers be more efficient. AWS Trusted Advisor monitors customer configurations, compares them to known best practices, and then notifies customers where opportunities exist to improve performance, enhance security, or save money. Yes, we are actively telling customers they're paying us more than they need to. In the last 90 days, customers have saved millions of dollars through Trusted Advisor, and the service is only getting started. All of this progress comes in the context of AWS being the widely recognized leader in its area – a situation where you might worry that external motivation could fail. On the other hand, internal motivation – the drive to get the customer to say "Wow" – keeps the pace of innovation fast.

Our heavy investments in Prime, AWS, Kindle, digital media, and customer experience in general strike some as too generous, shareholder indifferent, or even at odds with being a for-profit company. "Amazon, as far as I can tell, is a charitable organization being run by elements of the investment community for the benefit of consumers," writes one outside observer. But I don't think so. To me, trying to dole out improvements in a just-in-time fashion would be too clever by half. It would be risky in a world as fast-moving as the one we all live in. More fundamentally, I think long-term thinking squares the circle. Proactively delighting customers earns trust, which earns more business from those customers, even in new business arenas. Take a long-term view, and the interests of customers and shareholders align.

As I write this, our recent stock performance has been positive, but we constantly remind ourselves of an important point – as I frequently quote famed investor Benjamin Graham in our employee all-hands meetings – "In the short run, the market is a voting machine but in the long run, it is a weighing machine." We don't celebrate a 10% increase in the stock price like we celebrate excellent customer experience. We aren't 10% smarter when that happens and conversely aren't 10% dumber when the stock goes the other way. We want to be weighed, and we're always working to build a heavier company.

As proud as I am of our progress and our inventions, I know that we will make mistakes along the way – some will be self-inflicted, some will be served up by smart and hard-working competitors. Our passion for pioneering will drive us to explore narrow passages, and, unavoidably, many will turn out to be blind alleys. But – with a bit of good fortune – there will also be a few that open up into broad avenues.

I am incredibly lucky to be a part of this large team of outstanding missionaries who value our customers as much as I do and who demonstrate that every day with their hard work. As always, I attach a copy of our original 1997 letter. Our approach remains the same, and it's still Day 1.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.
April 2013

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(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click^{SM} shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareowners:

I'm so proud of what all the teams here at Amazon have accomplished on behalf of customers this past year. Amazonians around the world are polishing products and services to a degree that is beyond what's expected or required, taking the long view, reinventing normal, and getting customers to say "Wow."

I'd like to take you on a tour that samples a small subset of our various initiatives, ranging from Prime to Amazon Smile to Mayday. The goal is to give you a sense for how much is going on across Amazon and how exciting it is to work on these programs. This broad array of initiatives is only possible because a large team of talented people at every level are exercising their good judgment every day and always asking, how do we make this better?

Ok, let's get started on the tour.

Prime

Customers love Prime. More than one million customers joined Prime in the third week of December alone, and there are now tens of millions of Prime members worldwide. On a per customer basis, Prime members are ordering more items, across more categories, than ever before. Even internally, it's easy for us to forget that Prime was a new, unproven (some even said foolhardy) concept when we launched it nine years ago: all-you-can-eat, two-day shipping for a flat annual fee. At that time, we had one million eligible Prime products. This year, we passed 20 million eligible products, and we continue to add more. We've made Prime better in other ways too, adding new digital benefits – including the Kindle Owners' Lending Library and Prime Instant Video. And we're not done. We have many ideas for how to make Prime even better.

Readers & Authors

We're investing heavily on behalf of readers. The all-new, high-resolution, high-contrast Kindle Paperwhite launched to rave reviews. We integrated the very impressive Goodreads into Kindle, introduced FreeTime for Kindle, and launched Kindle in India, Mexico, and Australia. Bringing joy to air travelers, the FAA approved the use of electronic devices during takeoff and landing. Our public policy team, with the help of many allies, worked patiently for four years on this, at one point loading a test plane with 150 active Kindles. Yes, it all worked fine!

Joining CreateSpace, Kindle Singles, and Kindle Direct Publishing, is the new service Kindle Worlds, the literary journal Day One, eight new Amazon Publishing imprints, and the launch of Amazon Publishing in the UK and Germany. Thousands of authors are already using these services to build fulfilling writing careers. Many write and tell us how we have helped them send their children to college, pay off medical bills, or purchase a home. We are missionaries for reading and these stories inspire and encourage us to keep inventing on behalf of writers and readers.

Prime Instant Video

Prime Instant Video is experiencing tremendous growth across all metrics – including new customers, repeat usage, and total number of streams. These are output metrics and they suggest we are on a good path, focusing on the right inputs. Two of the key inputs are the growth of selection and the desirability of that selection. Since we launched PIV in 2011 with 5,000 titles, we've grown selection to more than 40,000 movies and TV episodes – all included in your Prime membership. PIV has exclusives on hundreds of sought after TV seasons including *Downton Abbey*, the ratings blockbuster *Under the Dome*, *The Americans*, *Justified*, *Grimm*, *Orphan Black*, *Suits,* and kids programs such as *SpongeBob SquarePants*, *Dora the Explorer*, and *Blue's Clues.* In addition, our Amazon Studios team continues to invest heavily in original content. Garry Trudeau's *Alpha House,* starring John Goodman, debuted last year and quickly became the most-watched show on Amazon. We recently greenlit six more originals, including *Bosch*, by Michael Connelly, *The After*, from Chris Carter of *The X-Files*, *Mozart in the Jungle*, from Roman Coppola and Jason Schwartzman, and Jill Soloway's beautiful *Transparent*, which some have called the best pilot in years. We like our approach and are replicating it with our recent rollout of PIV in both the UK and Germany. The early customer response in those countries has been terrific, surpassing our expectations.

Fire TV

Just this past week, after two years of hard work, our hardware team launched Fire TV. Not only is Fire TV the best way to watch Amazon's video offerings, it also embraces non-Amazon content services like Netflix, Hulu Plus, VEVO, WatchESPN, and many more. Fire TV has big hardware specs in a category that's previously been hardware-light. It shows. Fire TV is fast and fluid. And our ASAP technology predicts what you might want to watch and pre-buffers it, so shows start instantly. Our team also put a small microphone in the remote control. Hold down the mic button on the remote, and you can speak your search term rather than type it into an alphabet grid. The team has done a terrific job – the voice search actually works.

In addition to Prime Instant Video, Fire TV gives you instant access to over 200,000 movies and TV episodes available a la carte, including new releases like *Gravity*, *12 Years a Slave*, *Dallas Buyers Club*, *Frozen*, and more. As a bonus, Fire TV also lets you play high-quality, inexpensive games on your living room TV. We hope you try it out. If you do, let us know what you think. The team would love to hear your feedback.

Amazon Game Studios

It's early in the twenty-second century and Earth is threatened by an alien species, the Ne'ahtu. The aliens infected Earth's energy grid with a computer virus to disable the planet's defenses. Before they could strike, computer science prodigy Amy Ramanujan neutralized the alien virus and saved the planet. Now, the Ne'ahtu are back and Dr. Ramanujan must prevent them from launching an all-out invasion on Earth. She needs your help.

That's how *Sev Zero*, the first Fire TV exclusive from Amazon Game Studios, begins. The team combined tower defense with shooter gameplay and created a co-op mode where one player leads on the ground with their gamepad controller while a second player provides air support from a tablet. I can assure you that there are some intense moments when you'll appreciate a well-timed air-strike. When you see it, you may be surprised that this level of game play is possible on an inexpensive streaming media device. *Sev Zero* is only the first of a collection of innovative and graphically beautiful games we're building from the ground up for Fire tablets and Fire TV.

Amazon Appstore

The Amazon Appstore now serves customers in almost 200 countries. Selection has grown to include over 200,000 apps and games from top developers around the globe – nearly tripling in size over the past year. We introduced Amazon Coins, a virtual currency that saves customers up to 10% on app and in-app purchases. Our Whispersync for Games technology lets you start a game on one device and continue it on another without losing your progress. Developers can use the Mobile Associates program to offer millions of physical products from Amazon inside their apps, and earn referral fees when customers buy those items. We introduced Appstore Developer Select, a marketing program that promotes new apps and games on Kindle Fire tablets and on Amazon's Mobile Ad Network. We created Analytics and A/B Testing services – free services that empower developers to track user engagement and optimize their apps for iOS, Android, and Fire OS. Also this year, we embraced HTML5 web app developers. They too can now offer their apps on Kindle Fire and through the Amazon Appstore.

Spoken Word Audio

2013 was a landmark year for Audible, the world's largest seller and producer of audiobooks. Audible makes it possible for you to read when your eyes are busy. Millions of customers download hundreds of millions of audiobooks and other spoken-word programming from Audible. Audible customers downloaded close to 600 million listening hours in 2013. Thanks to Audible Studios, people drive to work listening to Kate Winslet, Colin Firth, Anne Hathaway, and many other stars. One big hit in 2013 was Jake Gyllenhaal's performance of

The Great Gatsby, which has already sold 100,000 copies. Whispersync for Voice allows customers to switch seamlessly back and forth between reading a book on their Kindle and listening to the corresponding Audible book on their smart phone. The Wall Street Journal called Whispersync for Voice "Amazon's new killer app for books." If you haven't already, I recommend you give it a try – it's fun and expands the amount of time you have available to read.

Fresh Grocery

After trialing the service for five years in Seattle (no one accuses us of a lack of patience), we expanded Amazon Fresh to Los Angeles and San Francisco. Prime Fresh members pay $299 a year and receive same-day and early morning delivery not only on fresh grocery items but also on over 500,000 other items ranging from toys to electronics to household goods. We're also partnering with favorite local merchants (the Cheese Store of Beverly Hills, Pike Place Fish Market, San Francisco Wine Trading Company, and many more) to provide the same convenient home delivery on a great selection of prepared foods and specialty items. We'll continue our methodical approach – measuring and refining Amazon Fresh – with the goal of bringing this incredible service to more cities over time.

Amazon Web Services

AWS is eight years old, and the team's pace of innovation is actually accelerating. In 2010, we launched 61 significant services and features. In 2011, that number was 82. In 2012, it was 159. In 2013: 280. We're also expanding our geographic footprint. We now have 10 AWS regions around the world, including the East Coast of the U.S., two on the West Coast, Europe, Singapore, Tokyo, Sydney, Brazil, China, and a government-only region called GovCloud. We have 26 availability zones across regions and 51 edge locations for our content distribution network. The development teams work directly with customers and are empowered to design, build, and launch based on what they learn. We iterate continuously, and when a feature or enhancement is ready, we push it out and make it instantly available to all. This approach is fast, customer-centric, and efficient – it's allowed us to reduce prices more than 40 times in the past 8 years – and the teams have no plans to slow down.

Employee Empowerment

We challenge ourselves to not only invent outward facing features, but also to find better ways to do things internally – things that will both make us more effective and benefit our thousands of employees around the world.

Career Choice is a program where we pre-pay 95% of tuition for our employees to take courses for in-demand fields, such as airplane mechanic or nursing, regardless of whether the skills are relevant to a career at Amazon. The goal is to enable choice. We know that for some of our fulfillment center employees, Amazon will be a career. For others, Amazon might be a stepping stone on the way to a job somewhere else – a job that may require new skills. If the right training can make the difference, we want to help.

The second program is called *Pay to Quit*. It was invented by the clever people at Zappos, and the Amazon fulfillment centers have been iterating on it. Pay to Quit is pretty simple. Once a year, we offer to pay our associates to quit. The first year the offer is made, it's for $2,000. Then it goes up one thousand dollars a year until it reaches $5,000. The headline on the offer is "Please Don't Take This Offer." We hope they don't take the offer; we want them to stay. Why do we make this offer? The goal is to encourage folks to take a moment and think about what they really want. In the long-run, an employee staying somewhere they don't want to be isn't healthy for the employee or the company.

A third inward innovation is our *Virtual Contact Center*. It's an idea we started a few years back and have continued to grow with terrific results. Under this program, employees provide customer service support for Amazon and Kindle customers while working from home. This flexibility is ideal for many employees who, perhaps because they have young children or for another reason, either cannot or prefer not to work outside the home. Our Virtual Contact Center is our fastest growing "site" in the U.S., operating in more than ten states today. This growth will continue as we hope to double our state footprint in 2014.

Veteran Hiring

We seek leaders who can invent, think big, have a bias for action, and deliver results on behalf of customers. These principles look familiar to men and women who've served our country in the armed forces, and we find that their experience leading people is invaluable in our fast-paced work environment. We're a member of Joining Forces and the 100,000 Jobs Mission – two national efforts that encourage businesses to offer service members and their families career opportunities and support. Our Military Talent team attended more than 50 recruiting events last year to help veterans find job opportunities at Amazon. In 2013, we hired more than 1,900 veterans. And once veterans join our team, we offer several programs that help them transition more easily into the civilian workforce and that connect them with our internal network of veterans for mentoring and support. These programs have earned us recognition as a top employer by G.I. Jobs Magazine, U.S. Veterans Magazine, and Military Spouse Magazine, and we'll continue to invest in military veteran hiring as we grow.

Fulfillment Innovation

Nineteen years ago, I drove the Amazon packages to the post office every evening in the back of my Chevy Blazer. My vision extended so far that I dreamed we might one day get a forklift. Fast-forward to today and we have 96 fulfillment centers and are on our 7th generation of fulfillment center design. Our operations team is extraordinary – methodical and ingenious. Through our Kaizen program, named for the Japanese term "change for the better," employees work in small teams to streamline processes and reduce defects and waste. Our Earth Kaizens set energy reduction, recycling, and other green goals. In 2013, more than 4,700 associates participated in 1,100 Kaizens.

Sophisticated software is key in our FCs. This year, we rolled out 280 major software improvements across the FC network. Our goal is to continue to iterate and improve on the design, layout, technology, and operations in these buildings, ensuring that each new facility we build is better than the last. I invite you to come see one for yourself. We offer fulfillment center tours open to the public, ages six and above. You can find info on the available tours at www.amazon.com/fctours. I'm always amazed when I visit one of our FCs, and I hope you'll arrange a tour. I think you'll be impressed.

Urban Campus

In 2013, we added 420,000 square feet of new headquarters space in Seattle and broke ground on what will become four city blocks and several million square feet of new construction. It is a fact that we could have saved money by instead building in the suburbs, but for us, it was important to stay in the city. Urban campuses are much greener. Our employees are able to take advantage of existing communities and public transit infrastructure, with less dependence on cars. We're investing in dedicated bike lanes to provide safe, pollution-free, easy access to our offices. Many of our employees can live nearby, skip the commute altogether, and walk to work. Though I can't prove it, I also believe an urban headquarters will help keep Amazon vibrant, attract the right talent, and be great for the health and wellbeing of our employees and the city of Seattle.

Fast Delivery

In partnership with the United States Postal Service, we've begun for the first time to offer Sunday delivery to select cities. Sunday delivery is a win for Amazon customers, and we plan to roll it out to a large portion of the U.S. population throughout 2014. We've created our own fast, last-mile delivery networks in the UK where commercial carriers couldn't support our peak volumes. In India and China, where delivery infrastructure isn't yet mature, you can see Amazon bike couriers delivering packages throughout the major cities. And there is more invention to come. The Prime Air team is already flight testing our 5th and 6th generation aerial vehicles, and we are in the design phase on generations 7 and 8.

Experiments and More Experiments

We have our own internal experimentation platform called "Weblab" that we use to evaluate improvements to our websites and products. In 2013, we ran 1,976 Weblabs worldwide, up from 1,092 in 2012, and 546 in 2011. One recent success is our new feature called "Ask an owner". It was many years ago that we pioneered the idea of online customer reviews – customers sharing their opinion on a product to help other customers make an informed purchase decision. "Ask" is in that same tradition. From a product page, customers can ask any question related to the product. *Is the product compatible with my TV/Stereo/PC? Is it easy to assemble? How long does the battery last?* We then route these questions to *owners* of the product. As is the case with reviews, customers are happy to share their knowledge to directly help other customers. Millions of questions have already been asked and answered.

Apparel and Shoes

Amazon Fashion is booming. Premium brands are recognizing that they can use Amazon to reach fashion-conscious, high-demo customers, and customers are enjoying the selection, free returns, detailed photos, and video clips that let them see how clothes move and drape as the models walk and turn. We opened a new 40,000 square foot photo studio in Brooklyn and now shoot an average of 10,413 photos every day in the studio's 28 bays. To celebrate the opening, we hosted a design contest with students from Pratt, Parsons, School of Visual Arts, and the Fashion Institute of Technology that was judged by a panel of industry leaders including Steven Kolb, Eva Chen, Derek Lam, Tracy Reese, and Steven Alan. Kudos to Parsons who took home the top prize.

Frustration-Free Packaging

Our battle against annoying wire ties and plastic clamshells rages on. An initiative that began five years ago with a simple idea that you shouldn't have to risk bodily injury opening your new electronics or toys, has now grown to over 200,000 products, all available in easy-to-open, recyclable packaging designed to alleviate "wrap rage" and help the planet by reducing packaging waste. We have over 2,000 manufacturers in our Frustration-Free Packaging program, including Fisher-Price, Mattel, Unilever, Belkin, Victorinox Swiss Army, Logitech, and many more. We've now shipped many millions of Frustration-Free items to 175 countries. We are also reducing waste for customers – eliminating 33 million pounds of excess packaging to date. This program is a perfect example of a missionary team staying heads-down focused on serving customers. Through hard work and perseverance, an idea that started with only 19 products is now available on hundreds of thousands and benefiting millions of customers.

Fulfillment by Amazon

The number of sellers using Fulfillment by Amazon grew more than 65% last year. Growth like that at such large scale is unusual. FBA is unique in many ways. It's not often you get to delight two customer sets with one program. With FBA, sellers can store their products in our fulfillment centers, and we pick, pack, ship, and provide customer service for these products. Sellers benefit from one of the most advanced fulfillment networks in the world, easily scaling their businesses to reach millions of customers. And not just any customers – Prime members. FBA products can be eligible for Prime free two-day shipping. Customers benefit from this additional selection – they get even more value out of their Prime membership. And, unsurprisingly, sellers see increased sales when they join FBA. In a 2013 survey, nearly three out of four FBA respondents reported that their unit sales increased on Amazon.com more than 20% after joining FBA. It's a win-win.

> *"FBA is the best employee I have ever had. … One morning I woke up and realized FBA had shipped 50 units. As soon as I realized I could sell products while I sleep, it was a no-brainer."*
> – Thanny Schuck, Action Sports LLC

> *"Starting out as an unknown brand, it was difficult to find retailers willing to stock our goods. No such barriers existed at Amazon. The beauty of Amazon is that someone can say, 'I want to start a business,' and they can go on Amazon and really start a business. You don't have to get a lease on a building or even have any employees at first. You can just do it on your own. And that's what I did."*
> – Wendell Morris, YogaRat

Login and Pay with Amazon

For several years we've enabled Amazon customers to pay on other sites, such as Kickstarter, SmugMug, and Gogo Inflight, using the credit cards and shipping addresses already stored in their Amazon account. This year, we expanded that capability so customers can also sign in using their Amazon account credentials, saving them the annoyance of needing to remember yet another account name and password. It's convenient for the customer and a business builder for the merchant. Cymax Stores, the online furniture retailer, has seen tremendous success with Login and Pay. It now accounts for 20% of their orders, tripling their new account registrations, and increasing purchase conversion 3.15% in the first three months. This example isn't unusual. We are seeing results like these with many partners, and the team is excited and encouraged. You should look for more in 2014.

Amazon Smile

In 2013 we launched Amazon Smile – a simple way for customers to support their favorite charitable organizations every time they shop. When you shop at smile.amazon.com, Amazon donates a portion of the purchase price to the charity of your choice. You'll find the same selection, prices, shipping options, and Prime eligibility on smile.amazon.com as you do on Amazon.com – you'll even find your same shopping cart and wish lists. In addition to the large, national charities you would expect, you can also designate your local children's hospital, your school's PTA, or practically any other cause you might like. There are almost a million charities to choose from. I hope you'll find your favorite on the list.

The Mayday Button

"Not only is the device awesome but the Mayday feature is absolutely FANTASTIC!!!!! The Kindle team has hit it out of the park with this one."

"Just tried the mayday button on my hdx. 15 second response time…amazon has done it again. Thoroughly impressed."

Nothing gives us more pleasure at Amazon than "*reinventing normal*" – creating inventions that customers love and resetting their expectations for what normal should be. Mayday reimagines and revolutionizes the idea of on-device tech support. Tap the Mayday button, and an Amazon expert will appear on your Fire HDX and can co-pilot you through any feature by drawing on your screen, walking you through how to do something yourself, or doing it for you – whatever works best. Mayday is available 24x7, 365 days a year, and our response time goal is 15 seconds or less. We beat that goal – with an average response time of only 9 seconds on our busiest day, Christmas.

A few of the Maydays have been amusing. Mayday Tech Advisors have received 35 marriage proposals from customers. 475 customers have asked to talk to Amy, our Mayday television personality. 109 Maydays have been customers asking for assistance with ordering a pizza. By a slim margin, Pizza Hut wins customer preference over Domino's. There are 44 instances where the Mayday Tech Advisor has sung Happy Birthday to the customer. Mayday Tech Advisors have been serenaded by customers 648 times. And 3 customers have asked for a bedtime story. Pretty cool.

I hope that gives you some sense of the scope of our opportunity and initiatives, as well the inventive spirit and push for exceptional quality with which they're undertaken. I should underscore again that this is a subset. There are many programs I've omitted in this letter that are just as promising, consequential, and interesting as those I've highlighted.

We have the good fortune of a large, inventive team and a patient, pioneering, customer-obsessed culture – great innovations, large and small, are happening everyday on behalf of customers, and at all levels throughout the company. This decentralized distribution of invention throughout the company – not limited to the company's senior leaders – is the only way to get robust, high-throughput innovation. What we're doing is challenging and fun – we get to work in the future.

Failure comes part and parcel with invention. It's not optional. We understand that and believe in failing early and iterating until we get it right. When this process works, it means our failures are relatively small in size (most experiments can start small), and when we hit on something that is really working for customers, we double-down on it with hopes to turn it into an even bigger success. However, it’s not always as clean as that. Inventing is messy, and over time, it’s certain that we’ll fail at some big bets too.

I’d like to close by remembering Joy Covey. Joy was Amazon’s CFO in the early days, and she left an indelible mark on the company. Joy was brilliant, intense, and so fun. She smiled a lot and her eyes were always wide, missing nothing. She was substance over optics. She was a long-term thinker. She had a deep keel. Joy was bold. She had a profound impact on all of us on the senior team and on the company’s entire culture. Part of her will always be here, making sure we watch the details, see the world around us, and all have fun.

I feel super lucky to be a part of the Amazon team. As always, I attach a copy of our original 1997 letter. Our approach remains the same, and it’s still Day 1.

Jeff P. Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.
April 2014

amazon.com

1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

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We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

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During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

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Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareowners:

A dreamy business offering has at least four characteristics. Customers love it, it can grow to very large size, it has strong returns on capital, and it's durable in time – with the potential to endure for decades. When you find one of these, don't just swipe right, get married.

Well, I'm pleased to report that Amazon hasn't been monogamous in this regard. After two decades of risk taking and teamwork, and with generous helpings of good fortune all along the way, we are now happily wed to what I believe are three such life partners: Marketplace, Prime, and AWS. Each of these offerings was a bold bet at first, and sensible people worried (often!) that they could not work. But at this point, it's become pretty clear how special they are and how lucky we are to have them. It's also clear that there are no sinecures in business. We know it's our job to always nourish and fortify them.

We'll approach the job with our usual tools: customer obsession rather than competitor focus, heartfelt passion for invention, commitment to operational excellence, and a willingness to think long-term. With good execution and a bit of continuing good luck, Marketplace, Prime, and AWS can be serving customers and earning financial returns for many years to come.

Marketplace

Marketplace's early days were not easy. First, we launched Amazon Auctions. I think seven people came, if you count my parents and siblings. Auctions transformed into zShops, which was basically a fixed price version of Auctions. Again, no customers. But then we morphed zShops into Marketplace. Internally, Marketplace was known as SDP for Single Detail Page. The idea was to take our most valuable retail real estate – our product detail pages – and let third-party sellers compete against our own retail category managers. It was more convenient for customers, and within a year, it accounted for 5% of units. Today, more than 40% of our units are sold by more than two million third-party sellers worldwide. Customers ordered more than two billion units from sellers in 2014.

The success of this hybrid model accelerated the Amazon flywheel. Customers were initially drawn by our fast-growing selection of Amazon-sold products at great prices with a great customer experience. By then allowing third parties to offer products side-by-side, we became more attractive to customers, which drew even more sellers. This also added to our economies of scale, which we passed along by lowering prices and eliminating shipping fees for qualifying orders. Having introduced these programs in the U.S., we rolled them out as quickly as we could to our other geographies. The result was a marketplace that became seamlessly integrated with all of our global websites.

We work hard to reduce the workload for sellers and increase the success of their businesses. Through our Selling Coach program, we generate a steady stream of automated machine-learned "nudges" (more than 70 million in a typical week) – alerting sellers about opportunities to avoid going out-of-stock, add selection that's selling, and sharpen their prices to be more competitive. These nudges translate to billions in increased sales to sellers.

To further globalize Marketplace, we're now helping sellers in each of our geographies – and in countries where we don't have a presence – reach out to our customers in countries outside their home geographies. We hosted merchants from more than 100 different countries last year, and helped them connect with customers in 185 nations.

Almost one-fifth of our overall third-party sales now occur outside the sellers' home countries, and our merchants' cross-border sales nearly doubled last year. In the EU, sellers can open a single account, manage their business in multiple languages, and make products available across our five EU websites. More recently, we've started consolidating cross-border shipments for sellers and helping them obtain ocean shipping from Asia to Europe and North America at preferential, bulk rates.

Marketplace is the heart of our fast-growing operations in India, since all of our selection in India is offered by third-party sellers. Amazon.in now offers more selection than any other e-commerce site in India – with more than 20 million products offered from over 21,000 sellers. With our Easy Ship service, we pick up products from a seller and handle delivery all the way to the end customer. Building upon Easy Ship, the India team recently piloted Kirana Now, a service that delivers everyday essentials from local kirana (mom and pop) stores to customers in two to four hours, adding convenience for our customers and increasing sales for the stores participating in the service.

Perhaps most important for sellers, we've created Fulfillment by Amazon. But I'll save that for after we discuss Prime.

Amazon Prime

Ten years ago, we launched Amazon Prime, originally designed as an all-you-can-eat free and fast shipping program. We were told repeatedly that it was a risky move, and in some ways it was. In its first year, we gave up many millions of dollars in shipping revenue, and there was no simple math to show that it would be worth it. Our decision to go ahead was built on the positive results we'd seen earlier when we introduced Free Super Saver Shipping, and an intuition that customers would quickly grasp that they were being offered the best deal in the history of shopping. In addition, analysis told us that, if we achieved scale, we would be able to significantly lower the cost of fast shipping.

Our owned-inventory retail business was the foundation of Prime. In addition to creating retail teams to build each of our category-specific online "stores," we have created large-scale systems to automate much of inventory replenishment, inventory placement, and product pricing. The precise delivery-date promise of Prime required operating our fulfillment centers in a new way, and pulling all of this together is one of the great accomplishments of our global operations team. Our worldwide network of fulfillment centers has expanded from 13 in 2005, when we launched Prime, to 109 this year. We are now on our eighth generation of fulfillment center design, employing proprietary software to manage receipt, stowing, picking, and shipment. Amazon Robotics, which began with our acquisition of Kiva in 2012, has now deployed more than 15,000 robots to support the stowing and retrieval of products at a higher density and lower cost than ever before. Our owned-inventory retail business remains our best customer-acquisition vehicle for Prime and a critical part of building out categories that attract traffic and third-party sellers.

Though fast delivery remains a core Prime benefit, we are finding new ways to pump energy into Prime. Two of the most important are digital and devices.

In 2011 we added Prime Instant Video as a benefit, now with tens of thousands of movies and TV episodes available for unlimited streaming in the U.S., and we've started expanding the program into the U.K. and Germany as well. We're investing a significant amount on this content, and it's important that we monitor its impact. We ask ourselves, is it worth it? Is it driving Prime? Among other things, we watch Prime free trial starts, conversion to paid membership, renewal rates, and product purchase rates by members entering through this channel. We like what we see so far and plan to keep investing here.

While most of our PIV spend is on licensed content, we're also starting to develop original content. The team is off to a strong start. Our show *Transparent* became the first from a streaming service to win a Golden Globe for best series and *Tumble Leaf* won the Annie for best animated series for preschoolers. In addition to the critical acclaim, the numbers are promising. An advantage of our original programming is that its first run is on Prime – it hasn't already appeared anywhere else. Together with the quality of the shows, that first run status appears to be one of the factors leading to the attractive numbers. We also like the fixed cost nature of original programming. We get to spread that fixed cost across our large membership base. Finally, our business model for original content is unique. I'm pretty sure we're the first company to have figured out how to make winning a Golden Globe pay off in increased sales of power tools and baby wipes!

Amazon designed and manufactured devices – from Kindle to Fire TV to Echo – also pump energy into Prime services such as Prime Instant Video and Prime Music, and generally drive higher engagement with every element of the Amazon ecosystem. And there's more to come – our device team has a strong and exciting roadmap ahead.

Prime isn't done improving on its original fast and free shipping promise either. The recently launched Prime Now offers Prime members free two-hour delivery on tens of thousands of items or one-hour delivery for a $7.99 fee. Lots of early reviews read like this one, "In the past six weeks my husband and I have made an embarrassing number of orders through Amazon Prime Now. It's cheap, easy, and insanely fast." We've launched in Manhattan, Brooklyn, Miami, Baltimore, Dallas, Atlanta, and Austin, and more cities are coming soon.

Now, I'd like to talk about Fulfillment by Amazon. FBA is so important because it is glue that inextricably links Marketplace and Prime. Thanks to FBA, Marketplace and Prime are no longer two things. In fact, at this point, I can't really think about them separately. Their economics and customer experiences are now happily and deeply intertwined.

FBA is a service for Marketplace sellers. When a seller decides to use FBA, they stow their inventory in our fulfillment centers. We take on all logistics, customer service, and product returns. If a customer orders an FBA item and an Amazon owned-inventory item, we can ship both items to the customer in one box – a huge efficiency gain. But even more important, when a seller joins FBA, their items can become Prime eligible.

Maintaining a firm grasp of the obvious is more difficult than one would think it should be. But it's useful to try. If you ask, what do sellers want? The correct (and obvious) answer is: they want more sales. So, what happens when sellers join FBA and their items become Prime eligible? They get more sales.

Notice also what happens from a Prime member's point of view. Every time a seller joins FBA, Prime members get more Prime eligible selection. The value of membership goes up. This is powerful for our flywheel. FBA completes the circle: Marketplace pumps energy into Prime, and Prime pumps energy into Marketplace.

In a 2014 survey of U.S. sellers, 71% of FBA merchants reported more than a 20% increase in unit sales after joining FBA. In the holiday period, worldwide FBA units shipped grew 50% over the prior year and represented more than 40% of paid third-party units. Paid Prime memberships grew more than 50% in the U.S. last year and 53% worldwide. FBA is a win for customers and a win for sellers.

Amazon Web Services

A radical idea when it was launched nine years ago, Amazon Web Services is now big and growing fast. Startups were the early adopters. On-demand, pay-as-you-go cloud storage and compute resources dramatically increased the speed of starting a new business. Companies like Pinterest, Dropbox, and Airbnb all used AWS services and remain customers today.

Since then, large enterprises have been coming on board as well, and they're choosing to use AWS for the same primary reason the startups did: speed and agility. Having lower IT cost is attractive, and sometimes the absolute cost savings can be enormous. But cost savings alone could never overcome deficiencies in performance or functionality. Enterprises are dependent on IT – it's mission critical. So, the proposition, "I can save you a significant amount on your annual IT bill and my service is almost as good as what you have now," won't get too many customers. What customers really want in this arena is "better and faster," and if "better and faster" can come with a side dish of cost savings, terrific. But the cost savings is the gravy, not the steak.

IT is so high leverage. You don't want to imagine a competitor whose IT department is more nimble than yours. Every company has a list of technology projects that the business would like to see implemented as soon as possible. The painful reality is that tough triage decisions are always made, and many projects never get done. Even those that get resourced are often delivered late or with incomplete functionality. If an IT department can figure out how to deliver a larger number of business-enabling technology projects faster, they'll be creating significant and real value for their organization.

These are the main reasons AWS is growing so quickly. IT departments are recognizing that when they adopt AWS, they get more done. They spend less time on low value-add activities like managing datacenters, networking, operating system patches, capacity planning, database scaling, and so on and so on. Just as important, they get access to powerful APIs and tools that dramatically simplify building scalable, secure, robust, high-performance systems. And those APIs and tools are continuously and seamlessly upgraded behind the scenes, without customer effort.

Today, AWS has more than a million active customers as companies and organizations of all sizes use AWS in every imaginable business segment. AWS usage grew by approximately 90% in the fourth quarter of 2014 versus the prior year. Companies like GE, Major League Baseball, Tata Motors, and Qantas are building new applications on AWS – these range from apps for crowdsourcing and personalized healthcare to mobile apps for managing fleets of trucks. Other customers, like NTT DOCOMO, the Financial Times, and the Securities and Exchange Commission are using AWS to analyze and take action on vast amounts of data. And many customers like Condé Nast, Kellogg's, and News Corp are migrating legacy critical applications and, in some cases, entire datacenters to AWS.

We've increased our pace of innovation as we've gone along – from nearly 160 new features and services in 2012, to 280 in 2013, and 516 last year. There are many that would be interesting to talk about – from WorkDocs and WorkMail to AWS Lambda and the EC2 Container Service to the AWS Marketplace – but for purposes of brevity, I'm going to limit myself to one: our recently introduced Amazon Aurora. We hope Aurora will offer customers a new normal for a very important (but also very problematic) technology that is a critical underpinning of many applications: the relational database. Aurora is a MySQL-compatible database engine that offers the speed and availability of high-end commercial databases with the simplicity and cost effectiveness of open source databases. Aurora's performance is up to 5x better than typical MySQL databases, at one-tenth the cost of commercial database packages. Relational databases is an arena that's been a pain point for organizations and developers for a long time, and we're very excited about Aurora.

I believe AWS is one of those dreamy business offerings that can be serving customers and earning financial returns for many years into the future. Why am I optimistic? For one thing, the size of the opportunity is big, ultimately encompassing global spend on servers, networking, datacenters, infrastructure software, databases, data warehouses, and more. Similar to the way I think about Amazon retail, for all practical purposes, I believe AWS is market-size unconstrained.

Second, its current leadership position (which is significant) is a strong ongoing advantage. We work hard – very hard – to make AWS as easy to use as possible. Even so, it's still a necessarily complex set of tools with rich functionality and a non-trivial learning curve. Once you've become proficient at building complex systems with AWS, you do not want to have to learn a new set of tools and APIs assuming the set you already understand works for you. This is in no way something we can rest on, but if we continue to serve our customers in a truly outstanding way, they will have a rational preference to stick with us.

In addition, also because of our leadership position, we now have thousands of what are effectively AWS ambassadors roaming the world. Software developers changing jobs, moving from one company to another, become our best sales people: "We used AWS where I used to work, and we should consider it here. I think we'd get more done." It's a good sign that proficiency with AWS and its services is already something software developers are adding to their resumes.

Finally, I'm optimistic that AWS will have strong returns on capital. This is one we as a team examine because AWS is capital intensive. The good news is we like what we see when we do these analyses. Structurally, AWS is far less capital intensive than the mode it's replacing – do-it-yourself datacenters – which have low utilization rates, almost always below 20%. Pooling of workloads across customers gives AWS much higher utilization rates, and correspondingly higher capital efficiency. Further, once again our leadership position helps: scale economies can provide us a relative advantage on capital efficiency. We'll continue to watch and shape the business for good returns on capital.

AWS is young, and it is still growing and evolving. We think we can continue to lead if we continue to execute with our customers' needs foremost in mind.

Career Choice

Before closing, I want to take a moment to update shareowners on something we're excited about and proud of. Three years ago we launched an innovative employee benefit – the Career Choice program, where we pre-pay 95% of tuition for employees to take courses for in-demand fields, such as airplane mechanic or nursing, regardless of whether the skills are relevant to a career at Amazon. The idea was simple: enable choice.

We know that, for some of our fulfillment and customer service center employees, Amazon will be a career. For others, Amazon might be a stepping stone on the way to a job somewhere else – a job that may require new skills. If the right training can make the difference, we want to help, and so far we have been able to help over 2,000 employees who have participated in the program in eight different countries. There's been so much interest that we are now building onsite classrooms so college and technical classes can be taught inside our fulfillment centers, making it even easier for associates to achieve these goals.

There are now eight FCs offering 15 classes taught onsite in our purpose-built classrooms with high-end technology features, and designed with glass walls to inspire others to participate and generate encouragement from peers. We believe Career Choice is an innovative way to draw great talent to serve customers in our fulfillment and customer service centers. These jobs can become gateways to great careers with Amazon as we expand around the world or enable employees the opportunity to follow their passion in other in-demand technical fields, like our very first Career Choice graduate did when she started a new career as a nurse in her community.

I would also like to invite you to come join the more than 24,000 people who have signed up so far to see the magic that happens after you click buy on Amazon.com by touring one of our fulfillment centers. In addition to U.S. tours, we are now offering tours at sites around the world, including Rugeley in the U.K. and Graben in Germany and continuing to expand. You can sign up for a tour at www.amazon.com/fctours.

*   *   *

Marketplace, Prime, and Amazon Web Services are three big ideas. We're lucky to have them, and we're determined to improve and nurture them – make them even better for customers. You can also count on us to work hard to find a fourth. We've already got a number of candidates in work, and as we promised some twenty years ago, we'll continue to make bold bets. With the opportunities unfolding in front of us to serve customers better through invention, we assure you we won't stop trying.

As always, I attach a copy of our original 1997 letter. Our approach remains the same, because it's still Day 1.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

amazon.com

1997 LETTER TO SHAREHOLDERS

(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

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The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

To our shareowners:

This year, Amazon became the fastest company ever to reach $100 billion in annual sales. Also this year, Amazon Web Services is reaching $10 billion in annual sales … doing so at a pace even faster than Amazon achieved that milestone.

What's going on here? Both were planted as tiny seeds and both have grown organically without significant acquisitions into meaningful and large businesses, quickly. Superficially, the two could hardly be more different. One serves consumers and the other serves enterprises. One is famous for brown boxes and the other for APIs. Is it only a coincidence that two such dissimilar offerings grew so quickly under one roof? Luck plays an outsized role in every endeavor, and I can assure you we've had a bountiful supply. But beyond that, there is a connection between these two businesses. Under the surface, the two are not so different after all. They share a distinctive organizational culture that cares deeply about and acts with conviction on a small number of principles. I'm talking about customer obsession rather than competitor obsession, eagerness to invent and pioneer, willingness to fail, the patience to think long-term, and the taking of professional pride in operational excellence. Through that lens, AWS and Amazon retail are very similar indeed.

A word about corporate cultures: for better or for worse, they are enduring, stable, hard to change. They can be a source of advantage or disadvantage. You can write down your corporate culture, but when you do so, you're discovering it, uncovering it – not creating it. It is created slowly over time by the people and by events – by the stories of past success and failure that become a deep part of the company lore. If it's a distinctive culture, it will fit certain people like a custom-made glove. The reason cultures are so stable in time is because people self-select. Someone energized by competitive zeal may select and be happy in one culture, while someone who loves to pioneer and invent may choose another. The world, thankfully, is full of many high-performing, highly distinctive corporate cultures. We never claim that our approach is the right one – just that it's ours – and over the last two decades, we've collected a large group of like-minded people. Folks who find our approach energizing and meaningful.

One area where I think we are especially distinctive is failure. I believe we are the best place in the world to fail (we have plenty of practice!), and failure and invention are inseparable twins. To invent you have to experiment, and if you know in advance that it's going to work, it's not an experiment. Most large organizations embrace the idea of invention, but are not willing to suffer the string of failed experiments necessary to get there. Outsized returns often come from betting against conventional wisdom, and conventional wisdom is usually right. Given a ten percent chance of a 100 times payoff, you should take that bet every time. But you're still going to be wrong nine times out of ten. We all know that if you swing for the fences, you're going to strike out a lot, but you're also going to hit some home runs. The difference between baseball and business, however, is that baseball has a truncated outcome distribution. When you swing, no matter how well you connect with the ball, the most runs you can get is four. In business, every once in a while, when you step up to the plate, you can score 1,000 runs. This long-tailed distribution of returns is why it's important to be bold. Big winners pay for so many experiments.

AWS, Marketplace and Prime are all examples of bold bets at Amazon that worked, and we're fortunate to have those three big pillars. They have helped us grow into a large company, and there are certain things that only large companies can do. With a tip of the hat to our Seattle neighbors, no matter how good an entrepreneur you are, you're not going to build an all-composite 787 in your garage startup – not one you'd want to fly in anyway. Used well, our scale enables us to build services for customers that we could otherwise never even contemplate. But also, if we're not vigilant and thoughtful, size could slow us down and diminish our inventiveness.

As I meet with teams across Amazon, I am continually amazed at the passion, intelligence and creativity on display. Our teams accomplished a lot in the last year, and I'd like to share a few of the highlights of our efforts to nourish and globalize our three big offerings – Prime, Marketplace and AWS. And while I'll focus on those three, I assure you that we also remain hard at work on finding a fourth.

Prime

We want Prime to be such a good value, you'd be irresponsible not to be a member.

We've grown Prime two-day delivery selection from 1 million items to over 30 million, added Sunday Delivery, and introduced Free Same-Day Delivery on hundreds of thousands of products for customers in more than 35 cities around the world. We've added music, photo storage, the Kindle Owners' Lending Library, and streaming films and TV.

Prime Now offers members one-hour delivery on an important subset of selection, and was launched only 111 days after it was dreamed up. In that time, a small team built a customer-facing app, secured a location for an urban warehouse, determined which 25,000 items to sell, got those items stocked, recruited and on-boarded new staff, tested, iterated, designed new software for internal use – both a warehouse management system and a driver-facing app – and launched in time for the holidays. Today, just 15 months after that first city launch, Prime Now is serving members in more than 30 cities around the world.

Prime Video offers exclusives from some of the world's most passionate storytellers. We want brilliant creators like Jill Soloway, Jason Schwartzman and Spike Lee to take risks and push boundaries. Our original series have already earned more than 120 nominations and won nearly 60 awards, including Golden Globe and Emmy awards. Many of these are stories that might never have been told in the traditional linear programming model. In the pipeline and coming soon are new series and movies from creators like Jeremy Clarkson, David E. Kelley, Woody Allen and Kenneth Lonergan.

The Man in the High Castle, based on the Philip K. Dick novel, explores an alternate history where the U.S. lost World War II. It debuted on Prime Video on November 20th and in four weeks became our most-viewed show – receiving acclaim from critics like "...Amazon has the best new drama of the season in *The Man in the High Castle*" and "*The Man in the High Castle* accomplishes so much, where most new broadcast TV dramas these days don't even try."

These shows are great for customers, and they feed the Prime flywheel – Prime members who watch Prime Video are more likely to convert from a free trial to a paid membership, and more likely to renew their annual subscriptions.

Finally, our first ever Prime Day surpassed all our expectations – more new members tried Prime that day than any other day in our history. Worldwide order growth increased 266% over the same day the year before, and sellers whose products are Prime-eligible through FBA saw record-breaking sales – with growth nearing 300%.

Prime has become an all-you-can-eat, physical-digital hybrid that members love. Membership grew 51% last year – including 47% growth in the U.S. and even faster internationally – and there are now tens of millions of members worldwide. There's a good chance you're already one of them, but if you're not – please be responsible – join Prime.

Marketplace

We took two big swings and missed – with Auctions and zShops – before we launched Marketplace over 15 years ago. We learned from our failures and stayed stubborn on the vision, and today close to 50% of units sold on Amazon are sold by third-party sellers. Marketplace is great for customers because it adds unique selection, and it's great for sellers – there are over 70,000 entrepreneurs with sales of more than $100,000 a year selling on

Amazon, and they've created over 600,000 new jobs. With FBA, that flywheel spins faster because sellers' inventory becomes Prime-eligible – Prime becomes more valuable for members, and sellers sell more.

This year, we created a new program called Seller Fulfilled Prime. We invited sellers who are able to meet a high bar for shipping speed and consistency in service to be part of the Prime program and ship their own orders at Prime speed directly. Those sellers have already seen a significant bump in sales, and the program has led to hundreds of thousands of additional items that are available to Prime customers via free two-day or next-day shipping in the U.S., U.K. and Germany.

We also created the Amazon Lending program to help sellers grow. Since the program launched, we've provided aggregate funding of over $1.5 billion to micro, small and medium businesses across the U.S., U.K. and Japan through short-term loans, with a total outstanding loan balance of about $400 million. Stephen Aarstol, surfer and owner of Tower Paddle Boards, is one beneficiary. His business has become one of the fastest-growing companies in San Diego, in part with a little help from Amazon Lending. Click-to-cash access to capital helps these small enterprises grow, benefits customers with greater selection, and benefits Amazon since our marketplace revenue grows along with the sellers' sales. We hope to expand Amazon Lending and are now working on ways to partner with banks so they can use their expertise to take and manage the bulk of the credit risk.

In addition to nourishing our big offerings, we work to globalize them. Our Marketplace creates opportunities for sellers anywhere to reach buyers around the world. In the past, many sellers would limit their customer base to their home country due to the practical challenges of selling internationally. To globalize Marketplace and expand the opportunities available to sellers, we built selling tools that empowered entrepreneurs in 172 countries to reach customers in 189 countries last year. These cross-border sales are now nearly a quarter of all third-party units sold on Amazon. To make this possible, we translated hundreds of millions of product listings and provided conversion services among 44 currencies. Even small and niche sellers can now tap into our global customer base and global logistics network. The end result is very different from sellers handling their own one-at-a-time, cross-border fulfillment. Plugable Technologies' CEO, Bernie Thompson, put it this way: "It really changes the paradigm when you're able to ship the goods in bulk to a warehouse in Europe or Japan and have those goods be fulfilled in one day or two days."

India is another example of how we globalize an offering like Marketplace through customer obsession and a passion for invention. Last year we ran a program called Amazon Chai Cart where we deployed three-wheeled mobile carts to navigate in a city's business districts, serve tea, water and lemon juice to small business owners and teach them about selling online. In a period of four months, the team traveled 15,280 km across 31 cities, served 37,200 cups of tea and engaged with over 10,000 sellers. Through this program and other conversations with sellers, we found out there was a lot of interest in selling online, but that sellers struggled with the belief that the process was time-consuming, tedious and complex. So, we invented Amazon Tatkal, which enables small businesses to get online in less than 60 minutes. Amazon Tatkal is a specially designed studio-on-wheels offering a suite of launch services including registration, imaging and cataloguing services, as well as basic seller training mechanisms. Since its launch on February 17th, we have reached sellers in 25 cities.

We're also globalizing Fulfillment by Amazon, adapting the service to local customer needs. In India, we launched a program called Seller Flex to combine Amazon's logistics capabilities with sellers' selection at the local neighborhood level. Sellers set aside a part of their warehouse for storing items to be sold on Amazon, and we configure it as a fulfillment center in our network that can receive and fulfill customer orders. Our team provides guidance on warehouse layout, IT and operational infrastructure, and trains the seller on standard operating procedures to be followed onsite. We've now launched 25 operational Seller Flex sites across ten cities.

Amazon Web Services

Just over 10 years ago, AWS started in the U.S. with its first major service, a simple storage service. Today, AWS offers more than 70 services for compute, storage, databases, analytics, mobile, Internet of Things, and enterprise applications. We also offer 33 Availability Zones across 12 geographic regions worldwide, with another five regions and 11 Availability Zones in Canada, China, India, the U.S., and the U.K. to be available in the coming year. AWS started with developers and startups, and now is used by more than a million customers from organizations of every size across nearly every industry – companies like Pinterest, Airbnb, GE, Enel, Capital One, Intuit, Johnson & Johnson, Philips, Hess, Adobe, McDonald's, and Time Inc.

AWS is bigger than Amazon.com was at 10 years old, growing at a faster rate, and – most noteworthy in my view – the pace of innovation continues to accelerate – we announced 722 significant new features and services in 2015, a 40% increase over 2014.

Many characterized AWS as a bold – and unusual – bet when we started. "What does this have to do with selling books?" We could have stuck to the knitting. I'm glad we didn't. Or did we? Maybe the knitting has as much to do with our approach as the arena. AWS is customer obsessed, inventive and experimental, long-term oriented, and cares deeply about operational excellence.

Given 10 years and many iterations, that approach has allowed AWS to rapidly expand into the world's most comprehensive, widely adopted cloud service. As with our retail business, AWS is made up of many small teams with single-threaded owners, enabling rapid innovation. The team rolls out new functionality almost daily across 70 services, and that new functionality just "shows up" for customers – there's no upgrading.

Many companies describe themselves as customer-focused, but few walk the walk. Most big technology companies are competitor focused. They see what others are doing, and then work to fast follow. In contrast, 90 to 95% of what we build in AWS is driven by what customers tell us they want. A good example is our new database engine, Amazon Aurora. Customers have been frustrated by the proprietary nature, high cost, and licensing terms of traditional, commercial-grade database providers. And while many companies have started moving toward more open engines like MySQL and Postgres, they often struggle to get the performance they need. Customers asked us if we could eliminate that inconvenient trade-off, and that's why we built Aurora. It has commercial-grade durability and availability, is fully compatible with MySQL, has up to 5 times better performance than the typical MySQL implementation, but is 1/10th the price of the traditional, commercial-grade database engines. This has struck a resonant chord with customers, and Aurora is the fastest-growing service in the history of AWS. Nearly this same story could be told about Redshift, our managed data warehouse service, which is the second fastest growing service in AWS history – both small and large companies are moving their data warehouses to Redshift.

Our approach to pricing is also driven by our customer-centric culture – we've dropped prices 51 times, in many cases before there was any competitive pressure to do so. In addition to price reductions, we've also continued to launch new lower cost services like Aurora, Redshift, QuickSight (our new Business Intelligence service), EC2 Container Service (our new compute container service), and Lambda (our pioneering server-less computing capability), while extending our services to offer a range of highly cost-effective options for running just about every type of application or IT use case imaginable. We even roll out and continuously improve services like Trusted Advisor, which alerts customers when they can save money – resulting in hundreds of millions of dollars in savings for our customers. I'm pretty sure we're the only IT vendor telling customers how to stop spending money with us.

Whether you are a startup founded yesterday or a business that has been around for 140 years, the cloud is providing all of us with unbelievable opportunities to reinvent our businesses, add new customer experiences, redeploy capital to fuel growth, increase security, and do all of this so much faster than before. MLB Advanced Media is an example of an AWS customer that is constantly reinventing the customer experience. MLB's Statcast tracking technology is a new feature for baseball fans that measures the position of each player, the baserunners, and the ball as they move during every play on the field, giving viewers on any screen access to empirical data that answers age-old questions like "what could have happened if…" while also bringing new questions to life. Turning baseball into rocket science, Statcast uses a missile radar system to measure every pitched ball's movements more than 2,000 times per second, streams and collects data in real-time through Amazon Kinesis (our service for processing real-time streaming data), stores the data on Amazon S3, and then performs analytics in Amazon EC2. The suite of services will generate nearly 7 TB of raw statistical data per game and up to 17 PB per season, shedding quantitative light on age-old, but never verified, baseball pearls of wisdom like "never slide into first."

About seven years ago, Netflix announced that they were going to move all their applications to the cloud. Netflix chose AWS because it provided them with the greatest scale and the broadest set of services and features. Netflix recently completed their cloud migration, and stories like theirs are becoming increasingly common as companies like Infor, Intuit, and Time Inc., have made plans to move all of their applications to AWS.

AWS is already good enough today to attract more than 1 million customers, and the service is only going to get better from here. As the team continues their rapid pace of innovation, we'll offer more and more capabilities to let builders build unfettered, it will get easier and easier to collect, store and analyze data, we'll continue to add more geographic locations, and we'll continue to see growth in mobile and "connected" device applications. Over time, it's likely that most companies will choose not to run their own data centers, opting for the cloud instead.

Invention Machine

We want to be a large company that's also an invention machine. We want to combine the extraordinary customer-serving capabilities that are enabled by size with the speed of movement, nimbleness, and risk-acceptance mentality normally associated with entrepreneurial start-ups.

Can we do it? I'm optimistic. We have a good start on it, and I think our culture puts us in a position to achieve the goal. But I don't think it'll be easy. There are some subtle traps that even high-performing large organizations can fall into as a matter of course, and we'll have to learn as an institution how to guard against them. One common pitfall for large organizations – one that hurts speed and inventiveness – is "one-size-fits-all" decision making.

Some decisions are consequential and irreversible or nearly irreversible – one-way doors – and these decisions must be made methodically, carefully, slowly, with great deliberation and consultation. If you walk through and don't like what you see on the other side, you can't get back to where you were before. We can call these Type 1 decisions. But most decisions aren't like that – they are changeable, reversible – they're two-way doors. If you've made a suboptimal Type 2 decision, you don't have to live with the consequences for that long. You can reopen the door and go back through. Type 2 decisions can and should be made quickly by high judgment individuals or small groups.

As organizations get larger, there seems to be a tendency to use the heavy-weight Type 1 decision-making *process* on most decisions, including many Type 2 decisions. The end result of this is slowness, unthoughtful risk aversion, failure to experiment sufficiently, and consequently diminished invention.[1] We'll have to figure out how to fight that tendency.

And one-size-fits-all thinking will turn out to be only one of the pitfalls. We'll work hard to avoid it… and any other large organization maladies we can identify.

Sustainability and Social Invention

Our growth has happened fast. Twenty years ago, I was driving boxes to the post office in my Chevy Blazer and dreaming of a forklift. In absolute numbers (as opposed to percentages), the past few years have been especially significant. We've grown from 30,000 employees in 2010 to more than 230,000 now. We're a bit like parents who look around one day and realize their kids are grown – you blink and it happens.

One thing that's exciting about our current scale is that we can put our inventive culture to work on moving the needle on sustainability and social issues.

Two years ago we set a long-term goal to use 100% renewable energy across our global AWS infrastructure. We've since announced four significant wind and solar farms that will deliver 1.6 million megawatt hours per

[1] The opposite situation is less interesting and there is undoubtedly some survivorship bias. Any companies that habitually use the light-weight Type 2 decision-making process to make Type 1 decisions go extinct before they get large.

year of additional renewable energy into the electric grids that supply AWS data centers. Amazon Wind Farm Fowler Ridge has already come online. We reached 25% sustainable energy use across AWS last year, are on track to reach 40% this year, and are working on goals that will cover all of Amazon's facilities around the world, including our fulfillment centers.

We'll keep expanding our efforts in areas like packaging, where our culture of invention led to a big winner – the Frustration-Free Packaging program. Seven years ago we introduced the initiative with 19 products. Today, there are more than 400,000 globally. In 2015, the program eliminated tens of millions of pounds of excess packaging material. Frustration-Free Packaging is a customer delighter because the packages are easier to open. It's good for the planet because it creates less waste. And it's good for shareholders because, with tighter packaging, we ship less "air" and save on transportation costs.

We also continue to pioneer new programs for employees – like Career Choice, Leave Share, and Ramp Back. Career Choice pre-pays 95% of tuition for courses that teach in-demand skills, regardless of whether those skills are relevant to a career at Amazon. We'll pay for nursing certifications, airplane mechanic courses, and many others. We're building classrooms with glass walls right in our fulfillment centers as a way to encourage employees to participate in the program and to make it easy. We see the impact through stories like Sharie Warmack – a single mother of eight who worked in one of our Phoenix fulfillment centers. Career Choice paid for Sharie to get licensed to drive an 18-wheeler. Sharie worked hard, passed her tests, and she's now a long-haul driver for Schneider Trucking – and loving it. This coming year, we're launching a program to teach other interested companies the benefits of Career Choice and how to implement it.

Leave Share and Ramp Back are programs that give new parents flexibility with their growing families. Leave Share lets employees share their Amazon paid leave with their spouse or domestic partner if their spouse's employer doesn't offer paid leave. Ramp Back gives birth mothers additional control over the pace at which they return to work. Just as with our health care plan, these benefits are egalitarian – they're the same for our fulfillment center and customer service employees as they are for our most senior executives.

Renewable energy, Frustration-Free Packaging, Career Choice, Leave Share, and Ramp Back are examples of a culture that embraces invention and long-term thinking. It's very energizing to think that our scale provides opportunities to create impact in these areas.

I can tell you it's a great joy for me to get to work every day with a team of such smart, imaginative, and passionate people. On behalf of all of us at Amazon, thank you for your support as shareholders. As always, I attach a copy of our original 1997 letter. Our approach remains the same, and it's still Day 1.

Jeff P Bezos

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

1997 LETTER TO SHAREHOLDERS
(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

"Jeff, what does Day 2 look like?"

That's a question I just got at our most recent all-hands meeting. I've been reminding people that it's Day 1 for a couple of decades. I work in an Amazon building named Day 1, and when I moved buildings, I took the name with me. I spend time thinking about this topic.

"Day 2 is stasis. Followed by irrelevance. Followed by excruciating, painful decline. Followed by death. And *that* is why it is *always* Day 1."

To be sure, this kind of decline would happen in extreme slow motion. An established company might harvest Day 2 for decades, but the final result would still come.

I'm interested in the question, how do you fend off Day 2? What are the techniques and tactics? How do you keep the vitality of Day 1, even inside a large organization?

Such a question can't have a simple answer. There will be many elements, multiple paths, and many traps. I don't know the whole answer, but I may know bits of it. Here's a starter pack of essentials for Day 1 defense: customer obsession, a skeptical view of proxies, the eager adoption of external trends, and high-velocity decision making.

True Customer Obsession

There are many ways to center a business. You can be competitor focused, you can be product focused, you can be technology focused, you can be business model focused, and there are more. But in my view, obsessive customer focus is by far the most protective of Day 1 vitality.

Why? There are many advantages to a customer-centric approach, but here's the big one: customers are *always* beautifully, wonderfully dissatisfied, even when they report being happy and business is great. Even when they don't yet know it, customers want something better, and your desire to delight customers will drive you to invent on their behalf. No customer ever asked Amazon to create the Prime membership program, but it sure turns out they wanted it, and I could give you many such examples.

Staying in Day 1 requires you to experiment patiently, accept failures, plant seeds, protect saplings, and double down when you see customer delight. A customer-obsessed culture best creates the conditions where all of that can happen.

Resist Proxies

As companies get larger and more complex, there's a tendency to manage to proxies. This comes in many shapes and sizes, and it's dangerous, subtle, and very Day 2.

A common example is process as proxy. Good process serves you so you can serve customers. But if you're not watchful, the process can become the thing. This can happen very easily in large organizations. The process becomes the proxy for the result you want. You stop looking at outcomes and just make sure you're doing the process right. Gulp. It's not that rare to hear a junior leader defend a bad outcome with something like, "Well, we followed the process." A more experienced leader will use it as an opportunity to investigate and improve the process. The process is not the thing. It's always worth asking, do we own the process or does the process own us? In a Day 2 company, you might find it's the second.

Another example: market research and customer surveys can become proxies for customers – something that's especially dangerous when you're inventing and designing products. "Fifty-five percent of beta testers report being satisfied with this feature. That is up from 47% in the first survey." That's hard to interpret and could unintentionally mislead.

Good inventors and designers *deeply* understand their customer. They spend tremendous energy developing that intuition. They study and understand many anecdotes rather than only the averages you'll find on surveys. They *live* with the design.

I'm not against beta testing or surveys. But you, the product or service owner, must understand the customer, have a vision, and love the offering. Then, beta testing and research can help you find your blind spots. A remarkable customer experience starts with heart, intuition, curiosity, play, guts, taste. You won't find any of it in a survey.

Embrace External Trends

The outside world can push you into Day 2 if you won't or can't embrace powerful trends quickly. If you fight them, you're probably fighting the future. Embrace them and you have a tailwind.

These big trends are not that hard to spot (they get talked and written about a lot), but they can be strangely hard for large organizations to embrace. We're in the middle of an obvious one right now: machine learning and artificial intelligence.

Over the past decades computers have broadly automated tasks that programmers could describe with clear rules and algorithms. Modern machine learning techniques now allow us to do the same for tasks where describing the precise rules is much harder.

At Amazon, we've been engaged in the practical application of machine learning for many years now. Some of this work is highly visible: our autonomous Prime Air delivery drones; the Amazon Go convenience store that uses machine vision to eliminate checkout lines; and Alexa,[1] our cloud-based AI assistant. (We still struggle to keep Echo in stock, despite our best efforts. A high-quality problem, but a problem. We're working on it.)

But much of what we do with machine learning happens beneath the surface. Machine learning drives our algorithms for demand forecasting, product search ranking, product and deals recommendations, merchandising placements, fraud detection, translations, and much more. Though less visible, much of the impact of machine learning will be of this type – quietly but meaningfully improving core operations.

Inside AWS, we're excited to lower the costs and barriers to machine learning and AI so organizations of all sizes can take advantage of these advanced techniques.

Using our pre-packaged versions of popular deep learning frameworks running on P2 compute instances (optimized for this workload), customers are already developing powerful systems ranging everywhere from early disease detection to increasing crop yields. And we've also made Amazon's higher level services available in a convenient form. Amazon Lex (what's inside Alexa), Amazon Polly, and Amazon Rekognition remove the heavy lifting from natural language understanding, speech generation, and image analysis. They can be accessed with simple API calls – no machine learning expertise required. Watch this space. Much more to come.

High-Velocity Decision Making

Day 2 companies make high-*quality* decisions, but they make high-quality decisions *slowly*. To keep the energy and dynamism of Day 1, you have to somehow make high-quality, *high-velocity* decisions. Easy for start-ups and very challenging for large organizations. The senior team at Amazon is determined to keep our decision-making velocity high. Speed matters in business – plus a high-velocity decision making environment is more fun too. We don't know all the answers, but here are some thoughts.

First, never use a one-size-fits-all decision-making process. Many decisions are reversible, two-way doors. Those decisions can use a light-weight process. For those, so what if you're wrong? I wrote about this in more detail in last year's letter.

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[1] For something amusing, try asking, "Alexa, what is sixty factorial?"

Second, most decisions should probably be made with somewhere around 70% of the information you wish you had. If you wait for 90%, in most cases, you're probably being slow. Plus, either way, you need to be good at quickly recognizing and correcting bad decisions. If you're good at course correcting, being wrong may be less costly than you think, whereas being slow is going to be expensive for sure.

Third, use the phrase "disagree and commit." This phrase will save a lot of time. If you have conviction on a particular direction even though there's no consensus, it's helpful to say, "Look, I know we disagree on this but will you gamble with me on it? Disagree and commit?" By the time you're at this point, no one can know the answer for sure, and you'll probably get a quick yes.

This isn't one way. If you're the boss, you should do this too. I disagree and commit all the time. We recently greenlit a particular Amazon Studios original. I told the team my view: debatable whether it would be interesting enough, complicated to produce, the business terms aren't that good, and we have lots of other opportunities. They had a completely different opinion and wanted to go ahead. I wrote back right away with "I disagree and commit and hope it becomes the most watched thing we've ever made." Consider how much slower this decision cycle would have been if the team had actually had to *convince* me rather than simply get my commitment.

Note what this example is not: it's not me thinking to myself "well, these guys are wrong and missing the point, but this isn't worth me chasing." It's a genuine disagreement of opinion, a candid expression of my view, a chance for the team to weigh my view, and a quick, sincere commitment to go their way. And given that this team has already brought home 11 Emmys, 6 Golden Globes, and 3 Oscars, I'm just glad they let me in the room at all!

Fourth, recognize true *misalignment* issues early and escalate them *immediately*. Sometimes teams have different objectives and fundamentally different views. They are not aligned. No amount of discussion, no number of meetings will resolve that deep misalignment. Without escalation, the default dispute resolution mechanism for this scenario is exhaustion. Whoever has more stamina carries the decision.

I've seen many examples of sincere misalignment at Amazon over the years. When we decided to invite third party sellers to compete directly against us on our own product detail pages – that was a big one. Many smart, well-intentioned Amazonians were simply not at all aligned with the direction. The big decision set up hundreds of smaller decisions, many of which needed to be escalated to the senior team.

"You've worn me down" is an awful decision-making process. It's slow and de-energizing. Go for quick escalation instead – it's better.

So, have you settled only for decision quality, or are you mindful of decision velocity too? Are the world's trends tailwinds for you? Are you falling prey to proxies, or do they serve you? And most important of all, are you delighting customers? We can have the scope and capabilities of a large company and the spirit and heart of a small one. But we have to choose it.

A huge thank you to each and every customer for allowing us to serve you, to our shareowners for your support, and to Amazonians everywhere for your hard work, your ingenuity, and your passion.

As always, I attach a copy of our original 1997 letter. It remains Day 1.

Sincerely,

Jeff

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

amazon.com

1997 LETTER TO SHAREHOLDERS
(Reprinted from the 1997 Annual Report)

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

We believe that a fundamental measure of our success will be the shareholder value we create over the *long term*. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.

- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.
- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click℠ shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million – an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000 – a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us substantial strategic flexibility.

Our Employees

The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success.

It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

Goals for 1998

We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.