AMAZON COM INC
Form 10-Q
October 23, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

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	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**

1200 12th Avenue South, Suite 1200, Seattle, Washington 98144-2734

(206) 266-1000

(Address and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

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

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

432,982,766 shares of common stock, par value $0.01 per share, outstanding as of October 19, 2009

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AMAZON.COM, INC.

FORM 10-Q

For the Quarterly Period Ended September 30, 2009

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	Twelve Months Ended September 30, 2009	Twelve Months Ended September 30, 2008
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 1,936	$ 1,548	$ 2,769	$ 2,539	$ 1,650	$ 1,366
OPERATING ACTIVITIES:						
Net income	199	118	518	420	743	627
Adjustments to reconcile net income to net cash from operating activities:						
Depreciation of fixed assets, including internal-use software and website development, and other amortization	96	76	266	210	343	273
Stock-based compensation	90	70	242	197	320	251
Other operating expense (income), net	9	7	80	(32)	90	(29)
Losses (gains) on sales of marketable securities, net	(1)	1	(3)	(2)	(3)	(2)
Other expense (income), net	(9)	(24)	(21)	(17)	(38)	(18)
Deferred income taxes	77	(17)	84	(47)	125	(144)
Excess tax charges (benefits) from stock-based compensation	17	(53)	(52)	(160)	(52)	(323)
Changes in operating assets and liabilities:						
Inventories	(276)	(243)	(192)	(130)	(293)	(361)
Accounts receivable, net and other	(155)	(9)	28	106	(296)	(131)
Accounts payable	701	362	(372)	(524)	964	620
Accrued expenses and other	(3)	101	(131)	39	77	437
Additions to unearned revenue	197	121	610	286	772	366
Amortization of previously unearned revenue	(143)	(86)	(375)	(220)	(499)	(291)
Net cash provided by (used in) operating activities	799	424	682	126	2,253	1,275
INVESTING ACTIVITIES:						
Purchases of fixed assets, including internal-use software and website development	(103)	(102)	(236)	(231)	(337)	(305)
Acquisitions, net of cash acquired, and other	(5)	(8)	(40)	(408)	(127)	(436)
Sales and maturities of marketable securities and other investments	586	582	1,277	1,033	1,550	1,149
Purchases of marketable securities and other investments	(780)	(478)	(1,730)	(1,229)	(2,179)	(1,382)
Net cash provided by (used in) investing activities	(302)	(6)	(729)	(835)	(1,093)	(974)
FINANCING ACTIVITIES:						
Excess tax benefits (charges) from stock-based compensation	(17)	53	53	160	52	323
Common stock repurchased					(100)	
Proceeds from long-term debt and other	101	2	97	62	149	91
Repayments of long-term debt and capital lease obligations	(20)	(295)	(379)	(355)	(394)	(380)
Net cash provided by (used in) financing activities	64	(240)	(229)	(133)	(293)	34
Foreign-currency effect on cash and cash equivalents	17	(76)	21	(47)	(3)	(51)

Net increase (decrease) in cash and cash equivalents	578	102	(255)	(889)	864	284
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 2,514	$ 1,650	$ 2,514	$ 1,650	$ 2,514	$ 1,650
SUPPLEMENTAL CASH FLOW INFORMATION:						
Cash paid for interest	$ 2	$ 14	$ 30	$ 61	$ 32	$ 62
Cash paid for income taxes	10	5	44	28	69	38
Fixed assets acquired under capital leases and other financing arrangements	60	37	97	104	141	136
Fixed assets acquired under build-to-suit leases	16	19	133	35	170	50
Conversion of debt		132		605		605

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

(unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net sales	$ 5,449	$ 4,264	$ 14,989	$ 12,463
Cost of sales	4,176	3,265	11,435	9,541
Gross profit	1,273	999	3,554	2,922
Operating expenses (1):				
Fulfillment	466	393	1,297	1,109
Marketing	149	108	406	313
Technology and content	315	264	890	755
General and administrative	83	73	228	208
Other operating expense (income), net	9	7	80	(32)
Total operating expenses	1,022	845	2,901	2,353
Income from operations	251	154	653	569
Interest income	7	21	28	67
Interest expense	(7)	(17)	(26)	(60)
Other income (expense), net	11	24	35	22
Total non-operating income (expense)	11	28	37	29
Income before income taxes	262	182	690	598
Provision for income taxes	(60)	(59)	(169)	(167)
Equity-method investment activity, net of tax	(3)	(5)	(3)	(11)
Net income	$ 199	$ 118	$ 518	$ 420
Basic earnings per share	$ 0.46	$ 0.28	$ 1.20	$ 1.00
Diluted earnings per share	$ 0.45	$ 0.27	$ 1.18	$ 0.97
Weighted average shares used in computation of earnings per share:				
Basic	432	427	431	421
Diluted	441	436	439	431
(1) Includes stock-based compensation as follows:				
Fulfillment	$ 22	$ 15	$ 57	$ 42
Marketing	5	4	14	10
Technology and content	48	38	130	109
General and administrative	15	13	41	36

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)

	September 30, 2009 (unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,514	$ 2,769
Marketable securities	1,487	958
Inventories	1,617	1,399
Accounts receivable, net and other	671	827
Deferred tax assets	80	204
Total current assets	6,369	6,157
Fixed assets, net	1,086	854
Deferred tax assets	206	145
Goodwill	457	438
Other assets	854	720
Total assets	$ 8,972	$ 8,314
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,354	$ 3,594
Accrued expenses and other	1,183	1,152
Total current liabilities	4,537	4,746
Long-term debt	116	409
Other long-term liabilities	734	487
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value:		
Authorized shares 500		
Issued and outstanding shares none		
Common stock, $0.01 par value:		
Authorized shares 5,000		
Issued shares 449 and 445		
Outstanding shares 433 and 428	4	4
Treasury stock, at cost	(600)	(600)
Additional paid-in capital	4,428	4,121
Accumulated other comprehensive loss	(35)	(123)
Accumulated deficit	(212)	(730)
Total stockholders equity	3,585	2,672
Total liabilities and stockholders equity	$ 8,972	$ 8,314

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1 Accounting Policies

Unaudited Interim Financial Information

We have prepared the accompanying consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. These consolidated financial statements are unaudited and, in our opinion, include all adjustments, consisting of normal recurring adjustments and accruals necessary for a fair presentation of our consolidated balance sheets, operating results, and cash flows for the periods presented. Operating results for the periods presented are not necessarily indicative of the results that may be expected for 2009 due to seasonal and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our 2008 Annual Report on Form 10-K. Certain prior period amounts have been reclassified to conform to the current period presentation.

Principles of Consolidation

The consolidated financial statements include the accounts of Amazon.com, Inc. (the Company), its wholly-owned subsidiaries, and those entities (relating primarily to www.amazon.cn) in which we have a variable interest and are the primary beneficiary. Intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities. Estimates are used for, but not limited to, valuation of investments, collectability of receivables, sales returns, incentive discount offers, valuation of inventory, depreciable lives of fixed assets and internally-developed software, valuation of acquired intangibles and goodwill, income taxes, stock-based compensation, and contingencies. Actual results could differ materially from those estimates.

Subsequent Events

We have evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through October 22, 2009, the day the financial statements were issued.

Earnings per Share

Basic earnings per share is calculated using our weighted-average outstanding common shares. Diluted earnings per share is calculated using our weighted-average outstanding common shares including the dilutive effect of stock awards as determined under the treasury stock method.

Treasury Stock

We account for treasury stock under the cost method and include treasury stock as a component of stockholders equity.

Accounts Receivable, Net and Other

Included in Accounts receivable, net and other on our consolidated balance sheets are amounts primarily related to vendor and customer receivables. At September 30, 2009 and December 31, 2008, vendor receivables, net, were $243 million and $400 million, and customer receivables, net, were $285 million and $311 million.

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Allowance for Doubtful Accounts

We estimate losses on receivables based on known troubled accounts and historical experience of losses incurred. The allowance for doubtful customer and vendor receivables was $84 million and $81 million at September 30, 2009 and December 31, 2008.

Internal-use Software and Website Development

Costs incurred to develop software for internal use are capitalized and amortized over the estimated useful life of the software. Costs related to design or maintenance of internal-use software are expensed as incurred. During Q3 2009 and Q3 2008, we capitalized $48 million (including $10 million of stock-based compensation) and $41 million (including $7 million of stock-based compensation) of costs associated with internal-use software and website development. For the nine months ended September 30, 2009 and 2008, we capitalized $134 million (including $25 million of stock-based compensation) and $139 million (including $20 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $44 million and $37 million for Q3 2009 and Q3 2008, and $126 million and $105 million for the nine months ended September 30, 2009 and 2008.

Depreciation of Fixed Assets

Fixed assets include assets such as furniture and fixtures, heavy equipment, technology infrastructure, internal-use software and website development. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets (generally two years or less for assets such as internal-use software, three years for our technology infrastructure, five years for furniture and fixtures, and ten years for heavy equipment). Depreciation expense is generally classified within the corresponding operating expense categories on our consolidated statements of operations, and certain assets are amortized as Cost of sales. Depreciation expense for fixed assets was $96 million and $80 million for Q3 2009 and Q3 2008, and $276 million and $225 million for the nine months ended September 30, 2009 and 2008.

Other Assets

Included in Other assets on our consolidated balance sheets are amounts primarily related to marketable securities restricted for longer than one year, the majority of which are attributable to collateralization of bank guarantees and debt related to our international operations; deferred costs; acquired intangible assets, net of amortization; certain equity investments; and intellectual property rights, net of amortization.

Investments

We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market funds. Such investments are included in Cash and cash equivalents or Marketable securities on the accompanying consolidated balance sheets, classified as available-for-sale and 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.

Equity investments are accounted for using the equity method of accounting if the investment gives us the ability to exercise significant influence, but not control, over an investee. The total of these investments in equity-method investees, including identifiable intangible assets, deferred tax liabilities and goodwill, is classified on our consolidated balance sheets as Other assets. Our share of the investees earnings or losses and amortization of the related intangible assets, if any, is classified as Equity-method investment activity, net of tax on our consolidated statements of operations.

Equity investments without readily determinable fair values for which we do not have the ability to exercise significant influence, are accounted for using the cost method of accounting. Under the cost method, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value,

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distributions of earnings, and additional investments. We classify our equity investments that have readily determinable fair values as available-for-sale and record these investments at their fair values with unrealized gains and losses, net of tax, included in Accumulated other comprehensive loss.

We periodically evaluate whether declines in fair values of our investments below their cost are other-than-temporary. This evaluation consists of several qualitative and quantitative factors regarding the severity and duration of the unrealized loss as well as our ability and intent to hold the investment until a forecasted recovery occurs. Factors considered include quoted market prices; recent financial results and operating trends; other publicly available information; implied values from any recent transactions or offers of investee securities; or other conditions that may affect the value of our investments.

Accrued Expenses and Other

Included in Accrued expenses and other at September 30, 2009 and December 31, 2008 were liabilities of $260 million and $270 million for unredeemed gift certificates. We reduce the liability for a gift certificate when it is applied to an order. If a gift certificate is not redeemed, we recognize revenue when it expires or, for a certificate without an expiration date, when the likelihood of its redemption becomes remote, generally two years from date of issuance.

Unearned Revenue

Unearned revenue is recorded when payments are received in advance of performing our service obligations and is recognized over the service period. Current unearned revenue is included in Accrued expenses and other and non-current unearned revenue is included in Other long-term liabilities on our consolidated balance sheets. Current unearned revenue was $372 million and $191 million at September 30, 2009 and December 31, 2008. Non-current unearned revenue was $103 million and $46 million at September 30, 2009 and December 31, 2008.

Income Taxes

Income tax expense includes U.S. and international income taxes. We do not provide for U.S. taxes on our undistributed earnings of foreign subsidiaries since we intend to invest such undistributed earnings indefinitely outside of the U.S. Determination of the unrecognized deferred tax liability that would be incurred if such amounts were repatriated is not practicable.

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when taxes are actually paid or recovered.

Deferred tax assets are evaluated for future realization and reduced by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience and expectations of future taxable income by taxing jurisdiction, the carry-forward periods available to us for tax reporting purposes, and other relevant factors. We allocate our valuation allowance to current and long-term deferred tax assets on a pro-rata basis.

We utilize a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies). The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. We include interest and penalties related to our tax contingencies in income tax expense.

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Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. To increase the comparability of fair value measures, the following hierarchy prioritizes the inputs to valuation methodologies used to measure fair value:

Level 1 Valuations based on quoted prices for identical assets and liabilities in active markets.

Level 2 Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 Valuations based on unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

Shipping Activities

Outbound shipping charges to customers are included in Net sales and were $208 million and $191 million for Q3 2009 and Q3 2008, and $583 million and $569 million for the nine months ended September 30, 2009 and 2008. Outbound shipping-related costs are included in Cost of sales and totaled $388 million and $323 million for Q3 2009 and Q3 2008, and $1.1 billion and $957 million for the nine months ended September 30, 2009 and 2008. The net cost to us of shipping activities was $180 million and $132 million for Q3 2009 and Q3 2008, and $494 million and $388 million for the nine months ended September 30, 2009 and 2008.

Stock-Based Compensation

Compensation cost for all stock-based awards is measured at fair value on date of grant and recognized over the service period for awards expected to vest. The fair value of restricted stock units is determined based on the number of shares granted and the quoted price of our common stock. Such value is recognized as expense over the service period, net of estimated forfeitures, using the accelerated method. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results and future estimates may differ substantially from our current estimates.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 167, *Amendments to FASB Interpretation No. 46(R)*. SFAS No. 167, which is incorporated in Accounting Standards Codification (ASC) Topic 810, *Consolidation*, requires a qualitative approach to identifying a controlling financial interest in a variable interest entity (VIE), and requires ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder the primary beneficiary of the VIE. SFAS No. 167 is effective for annual reporting periods beginning after November 15, 2009. We are currently evaluating the impact of the pending adoption of SFAS No. 167 on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 168, which is incorporated in ASC Topic 105, *Generally Accepted Accounting Principles*, identifies the ASC as the authoritative source of generally accepted accounting principles in the United States. Rules and interpretive releases of the SEC under federal

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securities laws are also sources of authoritative GAAP for SEC registrants. We adopted SFAS No. 168 in Q3 2009 and include references to the ASC within our consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, which amends ASC Topic 605, *Revenue Recognition*, to require companies to allocate revenue in multiple-element arrangements based on an element s estimated selling price if vendor-specific or other third-party evidence of value is not available. ASU 2009-13 is effective beginning January 1, 2011. Earlier application is permitted. We are currently evaluating both the timing and the impact of the pending adoption of the ASU on our consolidated financial statements.

Note 2 Cash, Cash Equivalents, and Marketable Securities

As of September 30, 2009 and December 31, 2008 our cash, cash equivalents, and marketable securities primarily consisted of cash, government and government agency securities, AAA-rated money market funds, and other investment grade securities. Such amounts are recorded at fair value. The following table summarizes, by major security type, our cash, cash equivalents, and marketable securities (in millions):

	September 30, 2009			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Estimated Fair Value
Cash	$ 320	$	$	$ 320
Money market funds	2,178			2,178
Foreign government and agency securities	1,223	9		1,232
U.S. government and agency securities	361	6		367
Corporate debt securities (1)	151	6		157
Asset-backed securities	47	1		48
Other fixed income securities	1			1
Equity securities	1			1
	$ 4,282	$ 22	$	$ 4,304
Less: Long-term marketable securities (2)				(303)
Total cash, cash equivalents, and marketable securities				$ 4,001

(1) Corporate debt securities include investments in financial, insurance, and corporate institutions. No single issuer represents a significant portion of the total corporate debt securities portfolio.

(2) We are required to pledge or otherwise restrict a portion of our marketable securities as collateral for standby letters of credit, guarantees, debt and real estate lease agreements. We classify cash and marketable securities with use restrictions of twelve months or longer as non-current Other assets on our consolidated balance sheets. See Note 4 Commitments and Contingencies.

The following table summarizes gross gains and gross losses realized on sales of available-for-sale marketable securities, including Euro-denominated securities (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Realized gains	$ 1	$ 3	$ 7	$ 8
Realized losses		4	4	6

Realized gains and losses are included in Other income (expense), net on our consolidated statements of operations.

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The following table summarizes, by major security type, our assets that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy (in millions):

	September 30, 2009				
	Cash	Level 1 Estimated Fair Value	Level 2 Estimated Fair Value	Level 3 Estimated Fair Value	Total Estimated Fair Value
Cash	$ 320	$	$	$	$