Amazon.com
Turning the Corner Toward Profitability?

REPORT OVERVIEW
By Paul Larson paull@fool.com

Amazon.com is the leading online retailer of books, music, and videos. Other product categories include toys, electronics, software, home improvement products, auctions, and online greeting cards.

The company is in the process of rapidly building a multifaceted online retail empire. Amazon has parlayed its lead in books to dominate other retail categories. The company has essentially doubled its online offerings in the last year, and we expect expansion into other categories to continue at a swift pace.

Amazon has been acting as a sort of Internet venture capitalist, funding other online retailing companies. Some of these investments, most notably Drugstore.com (Nasdaq: DSCM), have been highly profitable for Amazon on paper.

The company is nowhere near attaining profitability from operations at the moment. Significant losses are expected throughout 2000. However, the company’s oldest retail segment, books, turned profitable at the end of 1999, and volume gains and other operational efficiencies should help increase margins through the year. Positive earnings from all operations, if they do indeed come, will probably not arrive until 2002.

The bottom line is that Amazon is the largest and most aggressive pure-play consumer e-commerce company in the world. If one is a believer in the future of online retailing, there are few better bets than Amazon.

QUARTERLY FINANCIALS
(millions)

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ANNUAL FINANCIALS
(millions)

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QUOTE & BALANCE SHEET INFORMATION

TTM Price Range: ....................$41 - $113
Shares Outstanding: ..................338.4 million
Market Capitalization: ...................$26.0 billion
PE Ratio: ................................NA
Dividend Yield: ............................0.0%
12/31/99
Cash & Equivalents ...................$706.2 million
Total Assets: ............................$2,471.6 million
Long-term Debt: .........................$1,466.3 million
Total Liabilities: ......................$2,205.3 million
Shareholder Equity: ...................$266.3 million
Since Amazon.com went public on May 16, 1997, it has been one of the most heavily debated companies and investments on the stock market. The Motley Fool has followed the company since its inception. In this report, we aim to present the company in a clear light with hard facts and analysis. What are Amazon’s strengths and weaknesses? What potential is the company striving for? What opportunities and pitfalls exist for investors? Here, and with every report on Amazon to follow, we aim to help you, as an investor, answer these important questions in order to invest Foolishly.

BUSINESS DESCRIPTION
Based in Seattle, Amazon.com is the leading online retailer of books, music, and videos. Other product categories offered by the company include toys, electronics, software, home improvement products, auctions, and online greeting cards. The company opened its virtual doors in 1995 and quickly became the largest online seller of books. Amazon has since parlayed that lead and leveraged its large customer base to rapidly expand into additional retail categories. The goal? To be nothing short of a place where Internet users can buy and sell just about anything.

Amazon is also a venture capitalist of sorts and has funded numerous other Internet-related companies. The list of Amazon investees is extensive and includes Drugstore.com, HomeGrocer.com, Pets.com, and sports equipment provider Gear.com. Amazon has also been extremely active in acquiring other firms, and over the past two years it has purchased the Internet Movie Database, rare item site Exchange.com, online payment company Accept.com, live auction site LiveBid.com, online calendar and reminder service PlanetAll.com, marketing information gatherer Alexa, and the online operations of Tool Crib of the North. Amazon also has a warrant to purchase up to roughly 10% of credit card company NextCard (Nasdaq: NXCD). Other Amazon investees include Sotheby’s (NYSE: BID), Ashford (Nasdaq: ASFD), Greg Manning Auctions (Nasdaq: GMAI), Audible.com (Nasdaq: ADBL), and Living.com.

Simply said, Amazon is a firm that has its tentacles in numerous different areas, and the company is essentially without peer in regard to the scale of its online retail operations and the scope in which it has influence in the consumer e-commerce industry.

INDUSTRY ATTRACTIVENESS
Amazon is no longer just a bookseller, it is in the process of becoming an online site where consumers can find and purchase just about anything. Therefore, the total market opportunities for Amazon are probably best looked at by taking retail sales as a whole rather than by adding up the individual retail categories (books, music, electronics, etc.). Total U.S. retail sales were somewhere near $2.6 trillion in 1998, and less than 1% of those sales were due to e-commerce. However, by 2003 it is widely expected that online sales will account for anywhere from 4% to 8% of total retail sales domestically. Assuming 4% annual growth in total sales, this translates to a total market opportunity of roughly $125 billion to $250 billion overall for the consumer e-commerce merchants. Although few are bold enough to predict exact figures, 10 years from now the opportunities will be much larger.

These figures are only for the United States, yet there is literally a world of potential. European retail sales, for example, were $1.9 trillion in 1998. If Internet sales can reach a total market penetration of just 2%, that’s another $50 billion or so in market potential across the big pond come 2003. Asia and South America will also become fertile markets for e-commerce before long. To be concise, online stores have a worldwide presence, and it’s important to recognize the potential outside U.S. borders.

Of course, some retail categories are going to do much better online than others. Recorded music, for example, is expected to have approximately 15-20% of sales online in five years. Yet groceries and sporting goods are expected to have barely 2% of sales on the Internet.

There is a reason for the media spotlight on the industry as well as for the seemingly lofty stock market valuations. To make a long story short, the Internet and e-commerce mark the most important retailing phenomenon in our lifetimes, and we would be very foolish (small f) to ignore the investment opportunities this phenomenon is creating.

INDUSTRY CHARACTERISTICS

Pros
- Growth, growth, growth. Any industry that has the ability to go from zero to hundreds of billions of dollars in annual sales inside a decade has to grab attention.
- Relatively easy to scale. It is fairly easy for online merchants to quickly build out their centralized distribution systems. Companies in the industry

Amazon’s Key Metrics

<table>
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<th>Metric</th>
<th>Value</th>
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<td>Unique Customers</td>
<td>17 million</td>
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<tr>
<td>Media Metrix Ranking</td>
<td>7th most visited Web property</td>
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<tr>
<td>Unique Visitors</td>
<td>16.6 million</td>
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<tr>
<td>Unique Products</td>
<td>Roughly 18 million</td>
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Source: Media Metrix, December 1999
can sustain growth rates unheard of in the corporeal retail world.

- **Instant wide exposure.** When an online site opens, an e-tailer can have instant national (and international) attention.

- **Stores never close.** Except for the occasional site outage, virtual stores never close their doors. Keeping stores open around the clock is something few offline retailers can afford to do.

- **Unique cash flow characteristics.** Most e-commerce merchants are paid before they actually ship inventory to a customer. This means that there is minimal working capital needed to sustain these businesses.

- **Inventory turns fast.** For most retailers, inventory is evil. It ties up cash and depreciates rapidly. E-commerce companies tend to carry much lower inventories and turn over the inventory they have extremely fast.

- **Assets turn fast.** Since most online merchants have minimal start-up costs and physical assets, the capital needed to open and run an online store is relatively low. Most e-tailers turn over their invested capital much faster than the average offline retailer.

- **Tax advantage.** There is now a federal ban on e-commerce sales taxes. Unless you are in the same state where an e-tailer has a physical presence (someone in Seattle ordering from Amazon, for example), there is no sales tax. This will not change in the near-term, but could change in the long-term.

**Cons**

- **Low barriers to entry.** Setting up an online store is relatively inexpensive. The industry opportunity will continue to draw numerous competitors to the field.

- **Competition is high.** Not only is competition high today, but it will also likely remain high for the foreseeable future, especially as offline retailers start to come online in masses.

- **Comparison shopping is easy.** There are several online sites that offer “shop bots” that search online merchants for the lowest prices on any given item. Comparison shopping will become even easier in the future.

- **Margins will remain low.** Thanks to the ease with which comparison shopping can be done, merchants will have minimal power to raise prices. This means that margins will remain relatively low.

- **Marketing environment is very noisy.** The dot-com companies as a group are spending a disproportionate amount of money on advertising early in their lives, and vying for consumers’ attention is not easy in a crowded field.

- **Delay in getting items.** Whenever a consumer needs a physical item immediately, they will not go online to order it. The several days that it generally takes for items to arrive decreases the overall attractiveness of ordering online under certain circumstances.

- **Cost of fulfillment.** There will always be charges related to packing and shipping items to consumers.

- **Consumer confidence.** Many people like to kick the proverbial tires of what they’re buying, but physically seeing and touching items is not an option online. Consumers may get items that aren’t exactly what they expected. Plus, like trust, confidence takes a long time to build and is extremely easy to break.

**Rating**

Much of the positive rating of Amazon’s industry is due to the explosive growth expected in e-commerce, as well as the unique financial characteristics of the industry. Keeping the attractiveness rating below optimal are the high competition and low margins. There is no doubt that the e-commerce industry is an exciting one and that it will be more exciting in the next five years, perhaps, than at any other time after. However, there are some difficulties to overcome, and how companies attack these difficulties will separate the winners from the losers.
look at its number of repeat customers. In the most recent quarter, a full 73% of sales came from consumers who had previously bought from Amazon. This is impressive and speaks volumes about the positive experiences most users have when shopping at Amazon.com.

Retaining customers will separate winners from losers as e-commerce options expand. Given a large enough marketing budget, just about any company can attract customers at least once. However, those that have buyers who return again and again are the most likely to survive the next decade. For numerous different reasons, whether it be its customer service or its wide selection of products, Amazon has succeeded in retaining the most cumulative customers of any e-commerce merchant.

Amazon’s customer acquisition costs, which are the advertising dollars spent per new customer, are among the best in the industry. In the fourth quarter, Amazon said that its acquisition cost was $19 per new customer. By comparison, eToys.com (Nasdaq: ETYS) had an acquisition cost of $33 per new customer in the fourth quarter, and eToys is obviously a much more holiday-oriented operation than Amazon. Similar comparisons all point to the fact that Amazon is able to attract customers with comparatively small expenses per new customer.

Not only has the cumulative customer total at Amazon been skyrocketing, but sales per customer have also been steadily rising.

This is probably due to a combination of a greater selection at the Amazon site as well as increased consumer acceptance and trust of online buying as a whole. Another factor may be product mix, since electronics, Amazon’s newest major retail category, obviously carry higher sticker prices than books or music. Either way, Amazon indicated that it expects total sales per active customer to continue to increase throughout 2000.

Aiming to leverage its large customer base, Amazon has branched into other product areas. No other online merchant can open a new category and have the instant traffic that Amazon can attract. Some of the expansions away from its core books business, namely music and video, have been highly successful. Others, such as online greeting cards and auctions, have failed to make a meaningful impact in their markets yet. Either way, we fully expect Amazon to continue to try new things and roll out new online stores in numerous different retail categories throughout 2000. After all, Amazon’s goal is to be a place where anyone can buy anything anytime they wish.

Let’s now look at where Amazon stacks up in its individual retail categories.

**BOOKS**

Books are where it all started, and Amazon’s books business is easily the largest in the online retail industry. To say it is far above the competition would be an understatement. In the fourth quarter, Amazon’s book business generated $317 million in revenue. Its

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**Amazon Cumulative Customers**

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**Amazon’s Trailing 12-Month Sales Per Active Customer**

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<th>Video</th>
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Source: Amazon.com Q4 Conference Call
next largest competitor, Barnes & Noble.com (Nasdaq: BNBN), only generated $96 million in revenue over the holiday quarter. It is difficult to think of any other retail category, online or off, where the largest operator was more than triple the size of its next competitor.

Amazon also indicated that its book business was profitable in the fourth quarter. While it is uncertain just how profitable this segment of the company was since exact figures weren’t given, the fact that it has attained profitability at all should be a comforting fact for Amazon shareholders. If Amazon can duplicate its success in books in its other retail categories, the company will be in a very good position down the road as far as profits.

MUSIC
Back in 1998, it took Amazon only one quarter to become the leading online music seller, quickly surpassing CDNow (Nasdaq: CDNW) in size. Amazon is still the market leader since it generated $78 million in sales in the fourth quarter versus CDNow’s $53 million. When CDNow completes its merger with mail-order music retailer Columbia House later this year, Amazon will likely slip back into second place as far as size. However, the company doesn’t have to be the largest in order to be successful.

VIDEO
Amazon operates the largest online video store, generating $64 million in sales in the fourth quarter. The company’s video store also benefits from Amazon’s marketing deals with major movie studios. Amazon has been running special promotions of new releases as well as hosting informational websites about new movies. Also helping this segment is the continued consumer acceptance of DVD, as many people are upgrading their video collections to the new digital standard. Plenty of other sites, like Borders.com and Buy.com, sell videos online, but it does not appear any will come close to touching Amazon in sales in the near future.
TOYS
When Amazon opened its toy store ahead of this past holiday season, it quickly vaulted into the same league as industry leaders eToys and Toys R Us (NYSE: TOY). Amazon’s sales of children’s products was $95 million in the fourth quarter, just behind eToys’ $107 million. Just the fact that Amazon was able to go, in less than six months, from zero to $95 million in quarterly sales is extremely impressive and illustrates perfectly the way Amazon is able to leverage its current customer base into new areas. It should also be noted that while Amazon is not the largest toy seller in the online space, it had significantly fewer order fulfillment problems than its competitors. It is the author’s opinion that last holiday’s problems will come back to haunt Amazon’s competitors during the 2000 holiday season.

AUCTIONS
One area where Amazon has not been able to get any meaningful traction is its auction business. Even though its auction interface is arguably the best around and Amazon has the ability to cross-promote its auctions with other product offerings, the company still can’t hold a candle to the auction titan eBay (Nasdaq: EBAY). Auctions and zShops widen Amazon’s product offerings, but the company is still second fiddle in the consumer-to-consumer e-commerce industry. While it is easy to envision Amazon becoming king of business-to-consumer e-commerce, it may be little more than a court jester in the consumer-to-consumer kingdom.

ELECTRONICS AND OTHER NEW CATEGORIES
Electronics and Amazon’s other new retail categories such as software and tools failed to make a substantial contribution to the company during the most recent quarter. However, these are fairly new lines of business, and it will take time to grow these businesses to size. In other words, we’re not just expecting Amazon to branch into new retail categories over the next year, we are also expecting significant expansions of some of its existing but smaller categories.

BRINGING PARTNERS INTO THE FOLD
One of the more interesting things in recent weeks was to see Amazon sign agreements to start offering other Internet merchants the ability to sell items on the Amazon.com site. The most salient example is Drugstore.com, which is paying Amazon some $105 million over three years to have a tab on Amazon’s site. Similar deals have been struck with automotive site Greenlight.com, spoken-word site Audible.com, and home furnishings store Living.com. All together, Amazon has secured some $500 million in guaranteed marketing revenue over the next five years. It would not be surprising to see Amazon strike similar deals with numerous other e-commerce merchants, including some of the other firms it has already invested in. More on them later.

WALL STREET — A COLD PLACE FOR E-COMMERCE MERCHANTS
Luckily for current Amazon investors, Wall Street is now largely giving the cold shoulder to the consumer e-commerce industry. Nine months ago, raising money for a new online store was extremely easy. Today, the story is entirely different with the IPO market having cooled considerably for new retail ventures. Companies that did come public, such as eToys, Barnes & Noble.com, and even Amazon partner Drugstore.com, now find their stocks trading at fractions of their old highs (see charts on previous page).

While this may be frustrating for investors in consumer e-commerce companies, the reduced capital flow to the industry is actually a good thing for Amazon shareholders. It means that those upstart competitors wishing to make a frontal assault on Amazon are going to have a very difficult time raising cash ammunition to do so. However, the recent IPO of Amazon competitor Buy.com (Nasdaq: BUYX) shows that the capital spigot is not totally closed right now. In any case, it will take a company with very deep pockets to best Amazon’s size advantages, and, luckily, online retailing companies with deep pockets seem to be dwindling in number. In short, there will be many more losers than winners in the overall consumer e-commerce industry, and Amazon looks like it could be one of the select few to

<table>
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<td>NextCard</td>
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<tr>
<td>Greenlight.com</td>
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<tr>
<td>Drugstore.com (Nasdaq: DSCM)</td>
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<tr>
<td>Audible.com (Nasdaq: ADBL)</td>
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<tr>
<td>Living.com</td>
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<tr>
<td>Greg Manning (Nasdaq: GMAI)</td>
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**STOCK REPORT | AMAZON.COM | FEBRUARY 14, 2000 | PAGE 6**
end up in the winner’s circle.

To paraphrase a famous quote from Larry Ellison of Oracle (Nasdaq: ORCL), one can easily envision Jeff Bezos saying, “If e-commerce turns out to not be the future of retailing, we’re toast. But if it is, we’re golden.”

**RATING**

Amazon is in the early stages of building a powerful e-commerce empire, and the company is doing an excellent job of addressing the difficulties facing its industry. The company is far above its competition, and the distance between first and second appears to be widening. Overall, no other company comes close to Amazon in having as prime a position to potentially dominate the consumer e-commerce industry. Amazon’s vision of being a place to buy anything online stands an extremely good chance of coming true.

**BUSINESS QUALITY**

Amazon, of course, shares many of the same positive attributes as the industry as a whole. Namely, it has growth in spades and unique cash flow characteristics. Moreover, its business model allows the company to turn both its inventory and invested capital exceptionally fast, which is a highly attractive financial attribute. And in a low-margin industry, turning assets over quickly is necessary to achieve sufficient returns.

Expanding on these financial attributes, Amazon has an interesting situation in terms of its working capital needs. The company actually has a negative cash conversion cycle (minus 25 days at the end of the fourth quarter). This means that Amazon is able to collect its sales dollars from customers before it pays its distributors and vendors. Most retailers have significant amounts of cash tied up in inventory, and working capital is traditionally an expensive fuel needed for growth. However, Amazon is in an entirely different boat as its growth is essentially financed by its customers.

Another area of the business that Amazon may start to leverage more is its customer traffic. The company has recently signed several marketing arrangements with other e-commerce companies, and these other companies will be paying Amazon a pretty penny to lease space on Amazon’s valuable virtual real estate. These deals also further Amazon’s goal to be a place where online shoppers can buy just about anything.

Amazon has signed five such marketing deals just since the beginning of the year, and more are certainly on their way. It’s worth noting that these marketing deals will bring Amazon fairly high-margin revenue with minimal incremental cost. Amazon also has significant equity stakes in each of its marketing partners, which means it should be in a great position to profit from the potential success of its partners.

Before listing Amazon’s competitive advantages, it’s worth mentioning Amazon’s management quality. Even though the future of e-commerce is arguably foggy, Amazon has always had the pedal to the metal. Few firms exude the confidence that Amazon has about its future, which may be one of the reasons that it has attracted so much investor attention. The company is extremely aggressive and does not look to tone down its personality any time soon. Amazon simply would not be in the position that it is if it weren’t for the company’s visionary and risk-tolerant management.

**ECONOMIES OF SCALE**

Amazon’s most important competitive advantage that it is just beginning to benefit from is the so-called economies of scale. This is really just a fancy way of saying that since it is the largest, it can do things cheaper than its competitors. This includes everything from having massive bulk buying power with suppliers to having the fastest and most efficient distribution system. Not only does this mean it can pass cost savings on to consumers, but it also has the ability to sell things at prices that would be entirely unprofitable for competitors.

Think about it this way. Say I operate an online bookstore in competition with Amazon. We’re both selling the newest Stephen King book for $10. Let’s say Amazon is able to buy it from the publisher for $5 and get it to the consumer for $3. That’s $8 in costs on a $10 item for a gross profit of $2.

Now, since I’m a bit smaller, I have to pay the publisher $6 for the book instead of Amazon’s $5. What’s more, it costs me $4 to get it to the consumer, since I don’t have Amazon’s automated warehouses and have to pay an employee to hand-pack the order. That means my costs are $10 on this $10 book, giving me no profit versus Amazon’s profit of $2.

Now imagine Amazon drops the price to $9. If I meet its price, I’m losing a dollar while Amazon still makes a dollar. Amazon is able to do this because it has efficiencies of scale. Amazon, the largest company in the online shopping space and one of the only ones that has spent heavily to build automated warehouses, should have the lowest cost structure in terms of fulfillment, which is an incredibly important factor to consider.

Beyond the cost advantage in order fulfillment, Amazon can afford to spend aggressively on both product development (making the online buying experience more pleasant and more effective via smart recommendations) and marketing. Because it is the largest, Amazon can spend the most to improve this vital infrastructure and spread it out over a greater volume of sales. Amazon’s scale gives it key competitive advantages, and those advantages are what investors should focus on.

**AMAZON’S COMPETITIVE ADVANTAGES**

- **Economies of scale.** In a low-margin business, the companies that ultimately
succeed are those that can keep operating costs low. Amazon, being the largest, is in the process of building efficiencies of scale its upstart peers cannot match.

- **Leading market share.** Building a similar level of brand awareness is prohibitively expensive for Amazon’s competitors. Today, it would take literally billions of advertising dollars for another company to build the shopping traffic Amazon has been able to generate.

- **Marketing intelligence.** Thanks to having the most customers to track, Amazon’s Purchase Circles, recommended lists, customer reviews, and quick picks are just some of the shopping customization features in the company’s toolbox that may be difficult for competitors to duplicate.

- **1-Click patent.** Amazon has the patent for this technology that makes online shopping much easier and faster. This service allows previous customers to purchase an item with a single click of the mouse without having to re-enter information such as shipping address, credit card number, etc.

- **Cross-promotional opportunities.** Amazon has been able to (and will continue to) leverage its existing customer base to expand into new areas. What started as the world’s biggest bookstore is quickly becoming the world’s largest store of any kind.

- **An awesome brand.** Amazon has a well-respected and recognized brand. In fact, in a recent brand survey, Amazon was one of only two retailers on a worldwide list of 60 top brands, a list with all the usual suspects: Coca-Cola, Microsoft, Intel, and Pepsi. Plus, online competitors are tied up with restrictive names. Will toys sell at CDNow? Can electronics be sold at Barnes & Noble? Amazon, in the consumer mind, is becoming known as “the place to shop online... for anything.”

- **Huge selection, good prices, great customer service.** All in all, Amazon is among the most pleasant online sites to shop at. Repeat customer analysis supports this observation, as do industry studies and our own experiences and comparisons.

**RATING**

Although it may be a controversial rating due to Amazon’s lack of profits today, we think in the long run that Amazon’s true business quality will shine through. In addition, Amazon’s size will give it economies of scale and an inherent cost advantage over its competitors. Simply said, there are numerous sustainable competitive advantages within Amazon’s business model, and these advantages are the primary reason for the positive rating here.

**INVESTMENT PREDICTABILITY**

There’s no other way to say it. Amazon is a highly unpredictable company. It is this way for several reasons. First, the company is operating in an entirely new field, and it is always uncertain whether the pioneers in any given area will end up where they hope to be.

In addition, Amazon is not just growing the scale of its current operations, it is also rapidly expanding its scope. Amazon said that 2000 will bring even more category expansions than 1999, yet those of us looking at the company from the outside aren’t even sure what new lines of businesses are next on Amazon’s agenda. Amazon is quite simply off the scale when it comes to unpredictability.

Amazon also uses two types of leverage — operational and financial. On the operational side, Amazon’s fixed costs run high relative to its variable costs. This means that the company cannot attain profitability without significant sales growth to overcome its overhead expenses. Simply said, Amazon needs to execute nearly flawlessly on its vision in order to become profitable.

On the financial side, Amazon has quite a significant chunk of debt on its balance sheet. At the end of the last quarter, the company’s debt-to-equity ratio was 8.2x, which is quite lofty. This is due to the $1.5 billion in long-term debt Amazon has racked up as well as the declining equity in the business thanks to the past red ink. It also looks like the financial leverage will continue to increase over the next several quarters as more losses and spending are expected.

Looking at the other companies in the business, Amazon has an army of competitors gunning for it. There may be some advantages to being the largest, but Amazon’s size and goals mean that the company can count just about every retailer in the world as competition. Given the low barriers to entry in the e-commerce industry, there will also be numerous future start-ups to be dealt with. New competition always raises uncertainty.

There are also numerous online competitors out there today that are on a kamikaze mission to steal market share. Whether advertising like there’s no tomorrow or giving away the store by selling items below cost, the company has aggressive competitors nipping at its heels. While this sort of behavior is not sustainable, Amazon will nevertheless have to fend off these competitors.

**ABOUT OUR ESTIMATES**

One of the first things that went into
creating this report was the modeling and estimating of future profits. Even after doing extensive reading and listening closely to management’s every word about earnings guidance, it became apparent that the only certain thing about the future is uncertainty. Therefore, it’s important to take all forward estimates here with a grain (or four) of salt.

Trying to estimate Amazon’s profits is much like trying to predict the weather weeks in advance. We may have some vague ideas about where things are heading, but nailing precise numbers on a consistent basis is nearly impossible. That doesn’t prevent us from giving it the good old college try, since even a vague estimate about the future is better than going forward completely blind. In other words, when we publish forward profit estimates here, don’t take them as gospel but rather as a possibility of what could happen. The future trends are much more important than exact figures.

It should also become readily apparent when looking at Amazon’s valuation that much of today’s intrinsic value is due to cash flow that is expected several years in the future. There’s a lot that can happen in the next five years, and banking on profits further in the future is generally riskier than expecting profits from an established company today.

Finally, Amazon’s stock is even more unpredictable than the company it tracks. Being Foolish long-term investors, short-term volatility does not matter much to us. However, it is duly noted that Amazon’s stock is extremely volatile, and that presents a significant risk to shorter-term investors.

RATING
Amazon is a highly unpredictable company. Period. While we do have some general ideas about where the company is heading financially, estimating exact future sales or profit levels is largely a guessing game. If you need relative certainty when you invest, Amazon is not the place to put your dollars.

OVERALL PROSPECTS
This is the section where we tie up all the loose ends (and there are many with Amazon) and then take a look at where the company is headed against the backdrop of the company’s valuation. We’ve already covered the internal growth of Amazon, but one thing we haven’t talked about is Amazon’s sizable investments in other e-commerce retailers.

For several months now, Amazon has

<table>
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<tr>
<th>Amazon Forward Estimates</th>
<th>Q4 1999 (A)</th>
<th>Q1 2000 (E)</th>
<th>FY 1998 (A)</th>
<th>FY 1999 (A)</th>
<th>FY 2000 (E)</th>
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<td>600.0</td>
<td>609.8</td>
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<td>480.0</td>
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<td>Gross Profit</td>
<td>87.8</td>
<td>120.0</td>
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<td>290.6</td>
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<td>Est. Sales Fulfillment</td>
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<td>87.0</td>
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<td>Est. Advertising</td>
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<td>50.0</td>
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<td>Total Marketing &amp; Sales</td>
<td>179.4</td>
<td>137.0</td>
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<td>General &amp; Administrative</td>
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<td>30.0</td>
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<td>Mergers, Acquisitions, Investment Costs</td>
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<td>Amortization of Intangibles</td>
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<td>90.0</td>
<td>42.6</td>
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<td>Stock-based Compensation</td>
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<td>10.0</td>
<td>1.9</td>
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<td>Operating Income</td>
<td>(273.8)</td>
<td>(217.0)</td>
<td>(109.1)</td>
<td>(605.8)</td>
<td>(855.9)</td>
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<td>Adjusted Operating Income*</td>
<td>(175.3)</td>
<td>(112.0)</td>
<td>(61.0)</td>
<td>(352.4)</td>
<td>(402.9)</td>
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<td>Net Interest Expense</td>
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<td>Losses of equity in investees</td>
<td>(39.9)</td>
<td>(60.0)</td>
<td>(2.9)</td>
<td>(76.8)</td>
<td>(275.0)</td>
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<td>Net Loss</td>
<td>(323.2)</td>
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<td>(124.5)</td>
<td>(720.0)</td>
<td>(1195.9)</td>
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<td>Diluted Shares Outstanding</td>
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<td>EPS</td>
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<td>($0.42)</td>
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<td>Adjusted Net Income*</td>
<td>(184.9)</td>
<td>(124.0)</td>
<td>(73.6)</td>
<td>(389.8)</td>
<td>(467.9)</td>
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<td>Adjusted EPS*</td>
<td>($0.55)</td>
<td>($0.36)</td>
<td>($0.25)</td>
<td>($1.19)</td>
<td>($1.31)</td>
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<td>Gross Margin</td>
<td>13.0%</td>
<td>20.0%</td>
<td>21.9%</td>
<td>17.7%</td>
<td>20.7%</td>
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<tr>
<td>Adjusted Operating Margin*</td>
<td>-25.9%</td>
<td>-18.7%</td>
<td>-10.0%</td>
<td>-21.5%</td>
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<td>Net Margin</td>
<td>-47.8%</td>
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<td>-33.9%</td>
</tr>
<tr>
<td>Adjusted Net Margin*</td>
<td>-27.3%</td>
<td>-20.7%</td>
<td>-12.1%</td>
<td>-23.8%</td>
<td>-13.3%</td>
</tr>
</tbody>
</table>

* Adjustments exclude intangibles, stock-based compensation, merger, acquisition and investment related costs
Sources -- Company Filings, Press Releases, Conference Calls, Fool Estimates
been an aggressive investor in upstart “dot-com” retailers, acting as a sort of venture capitalist. The thought is that being the world’s largest consumer e-commerce company gives Amazon insight and experience needed to select the future e-commerce leaders. Having the largest customer base in the business doesn’t hurt, either.

The benefits of these investments to Amazon and its investees are several-fold. First, the investees have the experience of Amazon’s senior management to draw on to better grow their businesses. Second, Amazon has the ability to funnel some of its 17 million (and growing) unique shoppers toward these investees, greatly improving the traffic to its affiliate sites at little cost. For its part, Amazon gets these investments at fairly good prices and can personally help its investments grow.

Let’s take a peek at the estimated value of Amazon’s investment portfolio at the top of the page.

The reason we can only give approximate values is that many of these companies are private, and estimating a value for them is difficult if not impossible. Amazon has also purchased warrants in many of these companies — basically long-term options that give Amazon the right to increase its stake in the future. All the warrants above, at least the ones where the terms have been publicly disclosed, are “out of the money” and therefore don’t carry much value. Moreover, there is no precise way to value these warrants.

Either way, in order to see just how these investments have panned out, we need to estimate how much money Amazon has invested thus far.

As near as we can estimate, Amazon is sitting on roughly $382 million in paper gains on its investments in other e-commerce companies. Obviously, this number is only an estimate since the exact terms of many of Amazon’s investments have not been made public.

There’s also the previously mentioned problem of valuing private companies.

In addition, there is a huge difference between a paper gain and a real gain. Until Amazon sells (which it is unlikely to do), the company will continue to see accounting losses from these investments. Plus, the value of these investments is largely controlled by Wall Street, and a souring of the market toward consumer e-commerce companies could quickly destroy Amazon’s paper gains. Just look at Drugstore.com, which a few months ago was worth double what it is today. On the other hand, these newly public stocks may just be starting significant rallies that could bring Amazon a windfall. As always, time will tell.

These investments also show just how confident the management at Amazon is in the fate of the overall e-commerce industry. The bargain-basement prices at which Amazon is able to get these equity stakes doesn’t hurt, either. Needless to say, knowing where to invest, and where not to, are skills that make or break a business, because every business must know how to invest in itself, not just in outside parties. Amazon seems adept at both, but its ultimate success here is still very much an open question.

The bottom line is that Amazon may be best known as the largest gorilla in the consumer e-commerce forest, but it is also a savvy investor in the e-commerce industry and may see large financial benefits from these investments down the road. And while the precise value of Amazon’s investments is unknown, the company has made significant gains on its investments today.

**About Valuation**

When one looks at what Amazon has done so far and compares it to where the stock is today, it’s understandable to get a fear of heights. At a price-to-sales ratio several times the market average and without any historical profits, it is extremely easy to dismiss Amazon’s valuation as just plain crazy. However, the
stock’s value will not be determined by what happened in the past, but rather by what will happen in the future.

Looking ahead, we do not expect Amazon to become profitable any time soon. Even though the 1999 Christmas season was extremely strong for the company and Amazon topped most sales estimates, profits were still absent. In fact, the total company loss stood at $323.2 million for the fourth quarter, which is a massive loss any way you look at it.

The way that Amazon’s business model is set up, there is significant leverage built into the company’s operations. Right now, that leverage is working against profitability since Amazon is building for a future company several times larger than what it is today. Said another way, Amazon’s overhead expenses are unusually large relative to today’s sales volume. But if consumer e-commerce as a whole keeps growing and Amazon keeps its proportionate share, Amazon’s leverage will eventually bring the company to profitability. Amazon will be able to handle massive volume in the future without having extra costs. The company now has extra costs because it is waiting for sales to catch up to what its infrastructure can deliver.

In the current quarter, we are expecting sales of between $550 and $650 million with our best guess being $600 million. This is down sequentially from the fourth quarter since Amazon was greatly aided by the holidays. We expect gross margin to increase to 20%, which is the guidance the company gave to analysts.

Using an adjusted net income figure that blocks out the effects of intangibles, stock-based compensation, and merger, acquisition, and investment costs, we expect Amazon to post a loss of $0.36 per share. For reference, the average estimate on Wall Street is an adjusted loss of $0.35 per share, making our forecast slightly more pessimistic than the average.

Of course, one quarter is not going to make or break Amazon, but people will be looking very closely at the company’s margin trends. We are expecting not only gross margin to increase, but we also expect adjusted operating and net margins to look healthier. The net loss should also decrease in total size from the fourth quarter. The company indicated that its fourth quarter should, if its projections come true, represent the largest absolute loss it expects to ever see. That means that Amazon, it appears, is at an important inflection point.

### An Expensive Valuation

<table>
<thead>
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<th>(as of 2/6/00)</th>
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<tbody>
<tr>
<td><strong>Market Cap</strong></td>
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<tr>
<td><strong>Trailing EPS</strong></td>
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<tr>
<td><strong>Trailing PE</strong></td>
</tr>
<tr>
<td><strong>Book Value</strong></td>
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<tr>
<td><strong>Price-to-Book</strong></td>
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<tr>
<td><strong>Trailing Sales</strong></td>
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<tr>
<td><strong>Price-to-Sales</strong></td>
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<tr>
<td><strong>Dividend Yield</strong></td>
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For the full fiscal year, we expect Amazon to nearly double its sales yet again and report net revenue of over $3 billion. More importantly, we expect to see significant margin improvement across the board as the company starts to realize even further economies of scale. Marketing, product development, and general expenses should still increase, yet they should decline as a percentage of sales.

Amazon gave guidance to expect improving margins through the year for several reasons. First, the company will not be building any new warehouses, which should significantly slow spending on overhead expenses. As the company’s existing warehouses begin to be utilized more effectively, fulfillment costs as a percentage of sales should shrink. Furthermore, sales growth through the year is expected to eclipse the growth in advertising and product development, which will tend to increase the company’s net profit margins. Amazon will need to show improving margins through the year or the long-term viability of the company will come into serious question.

Overall, we expect the company to report an adjusted net loss of $1.31 per share for the full fiscal year, and this is slightly more pessimistic than the $1.14 loss the Street is expecting. Of course, it’s worth remembering that there is a reason we gave Amazon only one jester cap in the predictability rating, and the margin of error on our (and everyone else’s) forward estimates is not small.

Looking beyond 2000, we expect that 2001 will be the first year that earnings are sequentially better than the previous year. To get an idea of when Amazon will become profitable (assuming it becomes profitable at all), we have to get out our long-range telescope. As the years go by, we assume that Amazon will continue to see margin improvement as the economies of scale continue to kick in.

By 2003, we are assuming that gross margins will improve considerably from today’s 17.7% to about 25%. On the cost side, the overhead expenses of advertising, product development, and administrative costs should decrease rapidly as a percentage of sales. Today, these combined expenses suck up about 25% of sales, but we expect over time that this percentage will decrease to near 10%. Fulfillment costs are now in the 15-16% range, but Amazon said to expect these costs to decrease to near 9% of sales over the long-term. It should be evident that any future profitability is built on the assumption that Amazon will eventually realize economies of scale.

Put together, we expect Amazon to continue to see vibrant growth for the next several years. Absolute growth rates will continue to slow each year as the base of sales keeps rising. We don’t expect profitability to hit until 2002, and that estimate may even be too optimistic if the company cranks up its aggressiveness again and decides to expand at an even faster pace. For better or worse, here is what we expect from Amazon over the next four years. Again, it’s worth noting that these estimates are
just that — estimates. Our forward profit models will assuredly change as time goes by.

In trying to estimate the company’s intrinsic value by discounting future cash flows, we get a laughably large range of figures. Using the most pessimistic estimates and discounting at a hefty 20% rate, we show an intrinsic value near $4 per share. On the other hand, using the most optimistic estimates and discounting at 12%, we estimate an intrinsic value near $50. This is obviously a huge range, due to the fact that so much of the value is built on things that will happen 5 to 10 years in the future (and beyond).

Estimating the next quarter is difficult enough, much less 10 years from now. Either way, just about all of our models show that Amazon is today trading above its intrinsic value as figured by numbers alone.

The wild card in the valuation picture, aside from the value of Amazon’s brand and its position in the Internet landscape, is Amazon’s equity investments. Although the company has taken significant charges on the mergers and acquisitions line item of its income statement, the fact is the company has some fairly large paper gains on some of its investments.

Top-shelf companies rarely come on the cheap, and Amazon is no exception. Any way you slice it, Amazon’s stock trades at a high valuation when looked at by any traditional measure. Clearly the market is expecting large positive surprises from the company in the future.

Being Fools, we like to go against conventional wisdom and look at the risk factors alongside the reward factors. There is no doubt that Amazon’s stock is risky, but there’s also no doubt that the company has numerous powerful attributes, too.

**REWARD FACTORS**

- **E-commerce growth.** Amazon is the dominant force in the exploding consumer e-commerce industry. Given its outstanding positioning, Amazon is set to benefit greatly from the overall growth of online shopping.

- **Economies of scale.** Because the company is the largest online retailer, it should realize economies of scale. This is a key competitive advantage.

- **Sterling brand name.** When one thinks of shopping online, one is most likely to think of Amazon.com. The company has a valuable brand name to build upon.

- **Huge customer base.** The company has over 17 million cumulative customers and counting. This is a wide audience into which to introduce new retail categories.

- **Lots of page views.** Amazon’s large amount of consumer traffic (recently ranked seventh in the Media Metrix rankings) also makes Amazon’s pages valuable online real estate. The company is just starting to leverage this into advertising-related revenue. Amazon’s recent deal with Drugstore.com is likely just one of many to come.

- **Amazon’s stock is flying high.** The stock is a strong currency that can be used for further mergers and acquisitions. The company may also tap the capital markets for more cash if the need arises, since more capital can be raised with minimal dilution to current shareholders.

**Full Forward Snapshot**

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<tbody>
<tr>
<td>Net Sales</td>
<td>1639.8</td>
<td>3525.0</td>
<td>5000.0</td>
<td>7000.0</td>
<td>9000.0</td>
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<td>Gross Profit</td>
<td>290.6</td>
<td>730.6</td>
<td>1100.0</td>
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<td>Adjusted Operating Income*</td>
<td>-352.4</td>
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<td>630.0</td>
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<tr>
<td>Adjusted Net Income*</td>
<td>-389.8</td>
<td>-467.9</td>
<td>-230.0</td>
<td>140.0</td>
<td>550.0</td>
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<td>Diluted Shares Outstanding</td>
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<td>356.8</td>
<td>365</td>
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<td>Adjusted EPS*</td>
<td>$(1.19)</td>
<td>$(1.31)</td>
<td>$(0.63)</td>
<td>$0.37</td>
<td>$1.41</td>
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</table>

* Adjustments exclude intangibles, stock-based compensation, merger, acquisition and investment-related costs.
Sources -- Company Filings, Press Releases, Conference Calls, Fool Estimates
Equity investments. Amazon is an Internet venture capitalist of sorts, and its investments to date have registered significant paper gains. Few know the industry better than Amazon itself, making the company a shrewd investor.

Visionary management. Founder Jeff Bezos is a visionary and has surrounded himself with capable and talented people.

RISK FACTORS

Too much optimism. Predictions for e-commerce growth may be too optimistic. Expectations for the coming years are quite high, and much of Amazon's valuation is based on these expectations coming true.

Cost structure. It is imperative from a pricing and competitive standpoint, as well as from a profit standpoint, that Amazon does actually achieve significant economies of scale. If it does not, positive earnings will never result from the current business model.

Competitors. Amazon has numerous competitors today and probably always will have meaningful competition due to the low barriers to entry in the industry.

Low margins. Amazon has fairly low gross margins today, and gross margins will likely always stay at the lower end of the spectrum.

Offline companies coming online. Few bricks-and-mortar retailers have a coherent online strategy at this point, but that will change in the near future. The resources companies like Wal-Mart will bring to the battle are significant.

Valuation, valuation, valuation. Any way you look at it, Amazon is trading at some lofty valuations. A great deal of future optimism is already priced into the stock at today's levels.

RATING

Amazon is in a great position in an exploding industry. The company has the opportunity to lead the consumer e-commerce industry for many years, and Amazon has a grand vision to become the place where online shoppers can buy anything. It appears the company is at an inflection point concerning profitability, and the losses from operations should start to shrink in the coming quarters. And if the margins can continue to improve beyond that, profitability will be in the cards.

Assuming management can execute on its vision, Amazon’s long-term potential is excellent. The stock’s potential is a less certain prospect at current valuation levels, but even today could prove enticing for the long-term investor who believes in Amazon’s aggressive business plan. The company is highly unpredictable, but it is sure to give investors some positive surprises right along with a few negative ones. The one thing we can say for sure is that it takes a special kind of investor to invest in Amazon. Only those willing to do their homework and keep a close eye on the company's progress should be interested in the company.

OVERALL PROSPECTS

SUMMARY

In summary, e-commerce is the most important retailing phenomenon to happen in our lifetimes, and Amazon is the largest and most aggressive pure-play consumer e-commerce company in existence. The company has unique and sustainable competitive advantages that should allow it to continue to stand well above its peers. If one is an adamant believer in the future of online retailing, Amazon is a good place to consider investing, even at today’s admittedly rich valuations.

HOT ISSUES

In the spirit of the online FAQ (Frequently Asked Questions), below are Foolish takes on some of the most hotly debated issues concerning Amazon. Of course, the discussion never ends at the Amazon message board on the Fool.com site.

Q: Amazon has done nothing but rack up losses since inception, and even more red ink is expected. Will the company ever become profitable?

A: While there are no guarantees, our opinion is that Amazon will eventually become profitable. However, this profitability will probably not come on a quarterly basis until 2001 and not on a full-year basis until at least 2002. It’s worth keeping in mind that the company’s oldest business, domestic books, is currently profitable.

If the company keeps expanding its scope while also investing in dot-com start-ups, profitability will be delayed that much further. However, any eventual payoff should be that much larger, too.

Q: I’ve looked at the recent quarterly results, and the margins are all trending in the wrong direction. Gross and net margins are contracting while nearly all expenses as a percentage of sales are increasing. What's the deal?

A: New retail categories are not cheap to start. While the company does not yet disclose to the investment community its profitability by segment (only its sales are disclosed now), it is highly likely that the company’s older, established businesses (books, music, videos) have margin trends that look much better than that of the overall organization. Over time, we do not expect gross margins to expand more than a few percentage points. The expense margins are where the action is since they should look considerably better as the company begins to realize economies of scale. Having a larger base of stores from which to launch new product lines should also help.
Q: With debt that is largely at fixed rates, why is Amazon seemingly so sensitive to interest rate changes?

A: A dollar in 2003 is worth much less than a dollar today thanks to inflation and interest rates. The higher rates go (and the further profitability is delayed), the lower the present value of those future profits. In other words, the company’s overall earnings are not rate-sensitive at all, but the value of the expected future profitability is greatly influenced by changes in the rates at which investors discount cash flows. For Amazon, this is especially the case because the bulk of the company’s intrinsic value is due to profits that are at least several years away.

Q: The barriers to entry in online commerce are extremely low. Anyone can open an online store fairly cheaply. What is Amazon’s competitive strategy against this?

A: While it is true that the barriers to entry in the consumer e-commerce arena are extremely low, the barriers to sustained profitability (and brand-building) are quite high. Since online retailing will never be a high-margin affair, those that can build sales volume while containing costs are the only ones likely to survive in the long run. Since Amazon is by far the largest consumer e-commerce company (and brand) in existence, it should realize economies of scale that its smaller competitors will not realize.

Being the largest not only gives Amazon a cost advantage, it also allows the company to funnel cash toward new technologies. The company now has online shopping features, such as Purchase Circles and 1-Click, that other shopping sites do not have. By spending the highest amount of gross cash on product development, Amazon should be able to widen its lead in features and online usability and thus continue to have competitive advantages.

Q: Amazon has gone from an extremely “light” business model to one bogged down with expensive warehouses scattered across the country. Financially speaking, is Amazon now in the same expense ballpark as its bricks-and-mortar competitors?

A: It is true that Amazon’s former featherweight operating model is history. The company was initially able to get by with minimal inventory and a paltry amount of warehouse and operating space. However, the company has invested heavily in automated distribution centers across the country to increase its volume capabilities.

Nevertheless, I think Amazon’s business model is still comparatively light when you look at the fact that it does not have hundreds or thousands of outlets to build, stock, and maintain. Operating a handful of automated warehouses is still less expensive than building a traditional retailing empire one brick at a time. Moreover, operating a dozen warehouses is far cheaper and easier than operating a thousand retail stores.

From a cost perspective, controlling inventory is much easier with a centralized organization than it is with a distributed one. Said another way, maintaining inventory levels of Product A at 50 in a single warehouse is much easier than maintaining inventory levels of Product A at 20 in a thousand different locations. Additionally, vendors find it more cost-efficient to deal with a single, large company than to run salesmen to hundreds of different locations.

Amazon’s warehouses, while expensive to build in the first place, give Amazon tremendous competitive advantages against other online retailers. First, they reduce the shipping and processing time on any given order, making the consumer experience that much better. Just look at the flogging eToys and Toys R Us took after failing to process orders fast enough this past holiday. Amazon is on the other end of the spectrum as far as reputation. While not perfect at filling orders properly and on time, Amazon is light-years ahead of the others, thanks in large part to its distribution capacity.

More importantly, these warehouses give Amazon a cost advantage against other e-tailers. Since they are automated and located around the country (and overseas), they will give Amazon a cost advantage against those with less-automated order fulfillment services. Amazon, the largest company in the online shopping space, should have the lowest cost structure in terms of fulfillment. This is an important and sustainable competitive advantage.

Q: Sales growth is slowing at Amazon. Gone are the days of 200%+ year-over-year sales growth. Isn’t this troubling?

A: Sales growth at Amazon is certainly slowing on a percentage basis, but it is important to keep its growth in perspective. It is impossible for any company to keep doubling and tripling in size for more than a few years. Amazon is of a sufficient size now that the law of large numbers applies. It is growing from a large and expanding base, so it will grow at a slower rate percentage-wise. Moreover, there is more than enough room for slowing when a company is growing at 100% annually.

The growth rates will continue to slow in coming years on a percentage basis, but Amazon’s overall size will continue to expand. We expect growth to eventually slow to the 25-30% annual range in the intermediate term, which is still quite vibrant growth for a company as large as Amazon.

Q: The holiday season was huge for Amazon. If the company can’t make a profit at these large volumes, isn’t there something wrong?

A: This fact is certainly a yellow flag, but there are mitigating factors. Due to the strong demand for Amazon’s services, the company had to take extreme measures to fill orders. Amazon is trying
to attract new customers as well as keep
the ones it already has. This means that
fulfillment costs (the costs of actually
getting items to customers) now are
going to be relatively higher than in the
future. Last quarter, fulfillment costs
represented 16% of sales, but Amazon’s
long-term goal is to get this percentage
into the high single digits.

Again, Amazon has built several
large, automated warehouses. Even at
record sales volumes, the company will
only use a fraction of its distribution
capacity, and the warehouses will be a
major drain on profitability in the short
term. In the longer term, the extra
capacity should actually give Amazon a
cost advantage over its peers.

The overlying theme with all these
extra costs is that the company is still
engaged in an all-out battle for market
share, and the long-term positioning is
overriding any short-term profitability
concerns.

Q: Amazon’s valuation is just insane.
Why should I even bother owning such
an expensive stock?

A: Any way you slice it, Amazon’s stock
valuation comes out as lofty. However,
there are valid reasons why the market
has bid the stock up to today’s levels. If
e-commerce continues to explode like
most people think it will, Amazon’s
position as a leader in numerous
categories will be extremely valuable.
There is no doubt that plenty of future
good news is already built into the share
price, but Amazon also has the potential
to be among the most dominant retail
organizations on the planet, and it could
continue to surprise investors in the
process.

Q: What are the largest threats to
Amazon in the long run?

A: 1. Business model never becomes
profitable. Online retailing will always be
a low-margin affair, and there’s no
guarantee that Amazon or any of the
other dot-com companies will see

sufficient sales volume and gross margin
contribution for any meaningful
profitability. The ease with which
comparison shopping can be done on
the Internet will always keep prices
relatively low online.

2. IPO Market heating up. Several
months ago, venture capital and money
from IPOs was flowing to Internet
companies of all shapes and sizes in
unprecedented amounts. This made it
very easy for existing and would-be
competitors to load up on cash
ammunition to make an assault on
Amazon. Whether these investment
dollars are burned in undercutting on
price or for marketing, the well was deep
and full for competing companies to
raise cash. Luckily, things have cooled on
this front, but a soaring stock market for
e-tailers, if it comes again, may actually
hurt Amazon in the long run.

3. Offline retailers coming online. In the
near future, just about every company
will be online in some form. Many of
these established retail giants, like Wal-
Mart (NYSE: WMT) and Home Depot
(NYSE: HD), have literally billions of
dollars worth of cash flow from their
established operations that can be used
to grow their online sites. Many of the
bricks-and-mortar retailers are also
looking at some sort of blended
online/offline strategy. Right now,
Amazon simply has no way to match the
convenience and corporeal presence
offered by these offline stores. (Although
there has been talk about Amazon
opening small footprint retail stores for
ordering and returns.) Long story short,
the offline retailers are not going to go
down without a strong fight.

NEWS TIMELINE
Below is a news timeline of major events
that have happened at Amazon since the
beginning of 1999. From looking at all of
Amazon’s events in the past year or so, it
is fairly obvious that there has been a
flurry of activity surrounding the
company. All prices have been adjusted
for splits.

02/7/00 ($75) — Amazon announces its
intention to sell just shy of $600 million
worth of Euro-denominated convertible
debt.

02/3/00 ($84.19) — Amazon invests $5
million in Greg Manning auctions, a
publicly traded auctioneer of rare coins
and sports and entertainment
memorabilia. Greg Manning will begin
to offer items for sale at Amazon’s site.

02/2/00 ($69.44) — Amazon’s fourth
quarter earnings are announced. Results
are close to the latest expectations, but
the stock rallies the next day on renewed
optimism about the company’s future
profitability. Cumulative customer count
rises to over 17 million.

02/1/00 ($67.44) — Another day,
another deal. Amazon announces it is
taking an 18% equity stake in Living.com
and has warrants to purchase up to 27%
of the home furnishings site. In
exchange for being the exclusive home
design site on Amazon, the
company will receive $145 million in
guaranteed marketing revenue over five
years, bringing Amazon’s total future
marketing revenue to over $500 million.

01/31/00 ($64.56) — Amazon.com
announces it will buy a 5% stake in
spoken-word site Audible.com (Nasdaq:
ADBL). Audible’s content will be
available at the Amazon.com site, and
Amazon will in return receive $30
million in guaranteed marketing revenue
over three years.

01/24/00 ($70.13) — Drugstore.com
and Amazon announce new strategic
partnership. Amazon will invest an
additional $30 million into
Drugstore.com and in return will receive
$105 million in guaranteed marketing
revenue over the next three years. When
enacted, Drugstore.com will have a “tab”
on Amazon’s site.
01/21/00 ($62.06) — Amazon and Greenlight.com, an automobile site, announce promotional deal. Amazon will take a 5% stake in the company and get $87.5 million in guaranteed marketing revenue. Amazon also receives a warrant that could increase its total stake to 30%.

01/5/00 ($69.75) — Amazon announces initial results of its fourth quarter. Sales are expected to be above $650 million, far surpassing Wall Street expectations. The company also warns of unexpected inventory write-downs and higher costs which will cause the firm to report a higher loss than anticipated. Stock dives on the news.

12/2/1999 ($89.06) — Protecting its 1-Click patent, Amazon gets preliminary injunction against Barnes & Noble.

12/1/99 ($85) — Amazon makes investment in luxury goods retailer Ashford.com (Nasdaq: ASFD). In exchange for a $10 million investment and access to Amazon’s customer base, Amazon will receive approximately 7.4 million shares in Ashford.

11/30/99 ($85.06) — Amazon announces acquisition of catalog toy seller Back to Basics.

11/24/99 ($87.25) — Amazon says that on Nov. 16 it had its largest sales day ever. This surpasses its largest volume day of 1998, which was in mid-December. Average gift orders this season are $34.11, up from $28.50 in 1998.

11/10/99 ($72) — Credit-card company NextCard and Amazon announce alliance. NextCard will offer an Amazon-branded credit card, and Amazon will receive royalties from selling the cards. Amazon obtains warrant to buy up to 4.4 million shares of NextCard at $39.20 per share.

11/9/99 ($70.81) — Pets.com secures third round of financing, and Amazon is part of a syndicate to invest an additional $35 million in the online petstore. Details of the deal are not disclosed.

11/9/99 ($70.81) — Amazon launches four new retail categories — Home Improvement (Tools), Software, Video Games, and Gift Ideas. In conjunction with its Home Improvement launch, Amazon announces the purchase of Tool Crib of the North, a leading catalog retailer of tools.

11/8/99 ($78) — Amazon says it will make a significant announcement on November 9. Stock ends day at $78, up over 20% from the previous close.

10/27/99 ($75.94) — Third quarter earnings are released. Sales for the quarter are $356 million with a net loss of $197 million after merger-related charges. Cumulative customer count surpasses 13.1 million, and the company expects record volume of holiday orders. Company again warns of widening losses due to infrastructure build-out and investment spending, as well as stopgap measures to fill holiday orders. Amazon also states that its oldest business, books, should be profitable in the fourth quarter and perhaps for all of fiscal 2000.

10/12/99 ($84.94) — Amazon receives patent for its “1-Click” technology. Two weeks later the company sues Barnes & Noble for patent infringement.

10/4/99 ($77.06) — Amazon launches “Amazon Anywhere.” Allows those using Personal Digital Assistants and other mobile computers to shop on Amazon.

09/30/99 ($79.94) — Company introduces three new initiatives, including the zShops online store. zShops allows third-party retailers to sell items at Amazon’s site. Other two initiatives include Amazon Payments, which allows anyone to accept credit cards for a fee, and All Products Search, a service that searches the Web for items.

09/29/99 ($80.75) — Rumors swirl around the company, and a record 79.4 million shares of Amazon change hands in one trading session.

09/7/99 ($62.94) — Company names Warren Jensen as its CFO. Jensen was formerly the CFO of Delta Airlines as well as General Electric’s NBC division. Former Amazon CFO Joy Covey continues at Amazon as the company’s Chief Strategy Officer.

08/20/99 ($56.72) — Amazon introduces one use of its marketing intelligence — Purchase Circles. Allows public to see what items are bestsellers in certain locations, and at certain companies, universities, and more.

07/28/99 ($52.88) — Drugstore.com comes public. Shares quickly eclipse the $50 mark, giving Amazon a significant paper gain on its 11.4 million shares.

07/21/99 ($62.72) — Second quarter earnings are released. Quarterly sales are $314.4 million with a net loss of $138 million after merger-related charges. Company warns of even wider losses in the near future as spending and investments continue at rapid pace.

07/14/99 ($67.50) — Company invests in online retailer of sports equipment Gear.com. Amazon purchases approximately 49% of Gear’s stock.

07/13/99 ($63.06) — Amazon launches two new major retail categories at its site: Toys & Gifts and Electronics.

06/24/99 ($56.81) — Amazon names Joseph Galli President and Chief Operating Officer. Galli comes to Amazon after serving as Black and Decker’s President of worldwide power tools and accessories.

06/16/99 ($55.84) — Amazon and Sotheby’s join in strategic alliance. The two companies will work on a joint site to auction authenticated and guaranteed antiques and collectibles. Amazon also
makes an investment in Sotheby’s worth approximately $45 million.

06/14/99 ($46) — Pets.com secures second round of financing worth $50 million from Amazon and other venture capital firms. Amazon’s equity stake is increased to approximately 54%.

06/7/99 ($58.69) — Amazon announces it has reached the milestone of having 10 million cumulative customers.

05/28/99 ($59.38) — *The New York Times* demands Amazon stop using its bestseller list.

05/18/99 ($66.31) — Amazon purchases minority stake in HomeGrocer.com. For $42.5 million Amazon takes a 35% stake in the company.

05/17/99 ($68.81) — Company begins selling all titles on *The New York Times* bestseller list at a 50% discount.

04/28/99 ($96.75) — First quarter earnings are released. Company announces sales of $293.6 million and a net loss of $30.6 million. Customer count also reaches 8.4 million. Stock is weak after company warns of widening losses in coming quarters as it builds its online empire.

04/27/99 ($102.94) — Amazon launches its electronic greeting card service. The service is free and is intended simply to increase visitation to Amazon’s site.

04/26/99 ($103.59) — Company announces three major all-stock purchases with a total investment value near $645 million. It is buying Exchange.com, an online site that sells hard-to-find books and music. 1.9 million shares are issued for the purchase. Also purchased is Accept.com, a company working on simplifying e-commerce transactions. 1.8 million shares are issued to acquire Accept.com. Finally, the company announces it is purchasing Alexa, a company with technology that allows e-commerce sites to track buying and surfing habits of its customers. 4.4 million shares are issued to purchase Alexa. All three acquisitions close before the end of the second quarter.

04/12/99 ($92.22) — In a move to expand its auction services, Amazon purchases LiveBid.com in its entirety.

03/30/99 ($82.34) — Company opens its consumer-to-consumer auction site at the same time auction titan eBay is having major site outages. Stock responds well to the news, up over 10% in a single day.

03/29/99 ($74.81) — Amazon announces investment in Pets.com. Amazon purchases roughly a 50% stake in the online petstore.

02/24/99 ($55.47) — Amazon announces investment in Drugstore.com. Jeff Bezos joins Drugstore’s Board of Directors. At time of initial investment, Amazon owns a 46% stake.

01/28/99 ($61.44) — Company announces $500 million offering of subordinated debentures. When completed on February 3, the total size of the offering is expanded to $1.25 billion. Debentures yield 4.75% and are convertible into shares of common stock at $78.0275 per share.

01/26/99 ($57.55) — Company releases Q4 1998 and full year results. Sales in the fourth quarter are $252.9 million, almost quadruple the $66.0 million of sales seen in 1997’s Q4. Cumulative customer accounts reach 6.2 million.

Amazon.com is a component of The Motley Fool Now 50 Index.

**ABOUT THE FOOLISH ANALYST**

Paul Larson hails from the Chicago branch office of The Motley Fool, which is, um, his house. Paul started writing for the Fool in 1996 and he has been a regular writer for numerous different analytical features. Having once worked as a casino dealer while in college, Paul knows a thing or two about the gaming industry. He also studies the emerging consumer e-commerce industry and writes for *The Motley Fool’s Internet Report* and *The Motley Fool’s Industry Focus 2000*. Paul has a bachelor’s degree in biomedical engineering from the University of Illinois at Chicago, and an MBA from the Keller Graduate School of Management.

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Amazon is currently a holding in The Motley Fool’s Rule Breaker Portfolio.

Amazon is a business partner of The Motley Fool, Inc.
## Amazon Historical Financials — Quarterly

($ millions, except shares and EPS)

### Balance Sheet

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### Income Statement

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### Statement of Cash Flows

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|----------------------|----------|----------|----------|----------|----------|----------|----------|----------|

- Gross Margin
- Adjusted Operating Margin*
- Net Margin
- Adjusted Net Margin*

### Key Ratios

- Gross Margin
- Adjusted Operating Margin*
- Net Margin
- Adjusted Net Margin*
- Marketing % of Sales
- Product Dev. % of Sales
- General & Administrative % of Sales

* Adjustments exclude intangibles, stock-based compensation, merger, acquisition and investment-related costs
ND – Not Disclosed

Sources – Company Filings, Press Releases and Conference Calls
## Amazon Historical Financials — Annual

($ millions, except shares and EPS)

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Sources: Company Filings, Press Releases
ND: Not Disclosed
You can receive coverage of Amazon, plus every other stock we cover, by subscribing to unlimited access to Motley Fool Research for just $99. This Foolish offer won’t last forever!