
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

- ☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2019
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
(State or other jurisdiction of
incorporation or organization)

91-1646860
(I.R.S. Employer
Identification No.)

410 Terry Avenue North, Seattle, Washington 98109-5210
(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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

492,331,776 shares of common stock, par value \$0.01 per share, outstanding as of April 17, 2019

AMAZON.COM, INC.
FORM 10-Q
For the Quarterly Period Ended March 31, 2019
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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 March 31,		Twelve Months Ended March 31,	
	2018	2019	2018	2019
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, BEGINNING OF PERIOD	\$ 21,856	\$ 32,173	\$ 16,301	\$ 17,616
OPERATING ACTIVITIES:				
Net income	1,629	3,561	3,938	12,005
Adjustments to reconcile net income to net cash from operating activities:				
Depreciation and amortization of property and equipment and capitalized content costs, operating lease assets, and other	3,671	4,854	12,714	16,524
Stock-based compensation	1,182	1,274	4,605	5,509
Other operating expense (income), net	56	(13)	216	205
Other expense (income), net	(184)	(135)	(437)	268
Deferred income taxes	141	415	134	714
Changes in operating assets and liabilities:				
Inventories	2,220	719	(2,309)	(2,815)
Accounts receivable, net and other	1,029	(401)	(4,716)	(6,043)
Accounts payable	(10,216)	(6,384)	3,749	7,095
Accrued expenses and other	(2,225)	(2,932)	(538)	(235)
Unearned revenue	906	888	838	1,133
Net cash provided by (used in) operating activities	(1,791)	1,846	18,194	34,360
INVESTING ACTIVITIES:				
Purchases of property and equipment	(3,098)	(3,290)	(12,905)	(13,619)
Proceeds from property and equipment incentives	371	569	1,981	2,303
Acquisitions, net of cash acquired, and other	(13)	(1,169)	(13,939)	(3,342)
Sales and maturities of marketable securities	2,677	2,643	10,444	8,205
Purchases of marketable securities	(470)	(6,876)	(11,846)	(13,506)
Net cash provided by (used in) investing activities	(533)	(8,123)	(26,265)	(19,959)
FINANCING ACTIVITIES:				
Proceeds from long-term debt and other	125	190	16,332	833
Repayments of long-term debt and other	(202)	(351)	(1,463)	(817)
Principal repayments of finance leases	(2,015)	(2,214)	(5,981)	(7,649)
Principal repayments of financing obligations	(72)	(2)	(235)	(266)
Net cash provided by (used in) financing activities	(2,164)	(2,377)	8,653	(7,899)
Foreign currency effect on cash, cash equivalents, and restricted cash	248	(12)	733	(611)
Net increase (decrease) in cash, cash equivalents, and restricted cash	(4,240)	(8,666)	1,315	5,891
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, END OF PERIOD	\$ 17,616	\$ 23,507	\$ 17,616	\$ 23,507
SUPPLEMENTAL CASH FLOW INFORMATION:				
Cash paid for interest on long-term debt	\$ 282	\$ 286	\$ 607	\$ 858
Cash paid for operating leases	—	709	—	709
Cash paid for interest on finance leases	75	165	234	471
Cash paid for interest on financing obligations	54	2	153	142
Cash paid for income taxes, net of refunds	513	168	1,224	840
Assets acquired under operating leases	—	875	—	875
Property and equipment acquired under finance leases	2,270	2,628	10,020	10,972
Property and equipment acquired under build-to-suit arrangements	741	436	3,081	3,336

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)
(unaudited)

	Three Months Ended March 31,	
	2018	2019
Net product sales	\$ 31,605	\$ 34,283
Net service sales	19,437	25,417
Total net sales	51,042	59,700
Operating expenses:		
Cost of sales	30,735	33,920
Fulfillment	7,792	8,601
Marketing	2,699	3,664
Technology and content	6,759	7,927
General and administrative	1,067	1,173
Other operating expense (income), net	63	(5)
Total operating expenses	49,115	55,280
Operating income	1,927	4,420
Interest income	80	183
Interest expense	(330)	(366)
Other income (expense), net	239	164
Total non-operating income (expense)	(11)	(19)
Income before income taxes	1,916	4,401
Provision for income taxes	(287)	(836)
Equity-method investment activity, net of tax	—	(4)
Net income	\$ 1,629	\$ 3,561
Basic earnings per share	\$ 3.36	\$ 7.24
Diluted earnings per share	\$ 3.27	\$ 7.09
Weighted-average shares used in computation of earnings per share:		
Basic	484	491
Diluted	498	502

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in millions)
(unaudited)

	Three Months Ended March 31,	
	2018	2019
Net income	\$ 1,629	\$ 3,561
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of tax of \$21 and \$(1)	59	(8)
Net change in unrealized gains (losses) on available-for-sale debt securities:		
Unrealized gains (losses), net of tax of \$9 and \$0	(44)	32
Reclassification adjustment for losses (gains) included in "Other income (expense), net," net of tax of \$0 and \$0	2	1
Net unrealized gains (losses) on available-for-sale debt securities	(42)	33
Total other comprehensive income (loss)	17	25
Comprehensive income	\$ 1,646	\$ 3,586

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.
CONSOLIDATED BALANCE SHEETS
(in millions, except per share data)

	December 31, 2018	March 31, 2019 (unaudited)
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 31,750	\$ 23,115
Marketable securities	9,500	13,905
Inventories	17,174	16,432
Accounts receivable, net and other	16,677	15,979
Total current assets	75,101	69,431
Property and equipment, net	61,797	61,048
Operating leases	—	20,132
Goodwill	14,548	14,708
Other assets	11,202	12,783
Total assets	\$ 162,648	\$ 178,102
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current liabilities:		
Accounts payable	\$ 38,192	\$ 31,809
Accrued expenses and other	23,663	24,588
Unearned revenue	6,536	7,298
Total current liabilities	68,391	63,695
Long-term lease liabilities	9,650	33,275
Long-term debt	23,495	23,322
Other long-term liabilities	17,563	9,400
Commitments and contingencies (Note 4)		
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 — 514 and 516		
Outstanding shares — 491 and 492	5	5
Treasury stock, at cost	(1,837)	(1,837)
Additional paid-in capital	26,791	28,059
Accumulated other comprehensive loss	(1,035)	(1,010)
Retained earnings	19,625	23,193
Total stockholders' equity	43,549	48,410
Total liabilities and stockholders' equity	\$ 162,648	\$ 178,102

See accompanying notes to consolidated financial statements.

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 2019 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 in Item 8 of Part II, “Financial Statements and Supplementary Data,” of our 2018 Annual Report on Form 10-K.

Prior Period Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation, including the reclassification of long-term capital lease obligations that existed at December 31, 2018 from “Other long-term liabilities” to “Long-term lease liabilities” within the consolidated balance sheets, as a result of the adoption of new accounting guidance for leases. See “Accounting Pronouncements Recently Adopted.”

Principles of Consolidation

The consolidated financial statements include the accounts of Amazon.com, Inc., its wholly-owned subsidiaries, and those entities in which we have a variable interest and of which we are the primary beneficiary, including certain entities in India and China and that support our seller lending financing activities (collectively, the “Company”). Intercompany balances and transactions between consolidated entities are eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, income taxes, commitments and contingencies, valuation of acquired intangibles and goodwill, stock-based compensation forfeiture rates, vendor funding, and inventory valuation. Actual results could differ materially from those estimates.

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. In periods when we have a net loss, stock awards are excluded from our calculation of earnings per share as their inclusion would have an antidilutive effect.

The following table shows the calculation of diluted shares (in millions):

	Three Months Ended March 31,	
	2018	2019
Shares used in computation of basic earnings per share	484	491
Total dilutive effect of outstanding stock awards	14	11
Shares used in computation of diluted earnings per share	498	502

Accounts Receivable, Net and Other

Included in “Accounts receivable, net and other” on our consolidated balance sheets are amounts primarily related to customers, vendors, and sellers. As of December 31, 2018 and March 31, 2019, customer receivables, net, were \$9.4 billion and \$9.8 billion, vendor receivables, net, were \$3.2 billion and \$2.5 billion, and seller receivables, net, were \$710 million and \$660 million. Seller receivables are amounts due from sellers related to our seller lending program, which provides funding to sellers primarily to procure inventory.

Leases

We categorize leases with contractual terms longer than twelve months as either operating or finance. Finance leases are generally those leases that allow us to substantially utilize or pay for the entire asset over its estimated life. Assets acquired under finance leases are recorded in property and equipment, net. All other leases are categorized as operating leases. Our leases generally have terms that range from two to ten years for equipment and two to twenty years for property.

Certain lease contracts include obligations to pay for other services, such as operations and maintenance. For leases of property, we account for these other services as a component of the lease. For substantially all other leases, the services are accounted for separately and we allocate payments to the lease and other services components based on estimated stand-alone prices.

Lease liabilities are recognized at the present value of the fixed lease payments, reduced by landlord incentives using a discount rate based on similarly secured borrowings available to us. Lease assets are recognized based on the initial present value of the fixed lease payments, reduced by landlord incentives, plus any direct costs from executing the leases. Lease assets are tested for impairment in the same manner as long-lived assets used in operations. Leasehold improvements are capitalized at cost and amortized over the lesser of their expected useful life or the lease term.

When we have the option to extend the lease term, terminate the lease before the contractual expiration date, or purchase the leased asset, and it is reasonably certain that we will exercise the option, we consider these options in determining the classification and measurement of the lease. Our leases may include variable payments based on measures that include changes in price indices, market interest rates, or the level of sales at a physical store, which are expensed as incurred.

Costs associated with operating lease assets are recognized on a straight-line basis within operating expenses over the term of the lease. Finance lease assets are amortized within operating expenses on a straight-line basis over the shorter of the estimated useful lives of the assets or the lease term. The interest component of a finance lease is included in interest expense and recognized using the effective interest method over the lease term.

Financing Obligations

We record assets and liabilities for estimated construction costs under build-to-suit lease arrangements when we have control over the building during the construction period. If we continue to control the building after the construction period, the arrangement is classified as a financing obligation instead of a lease. The building is depreciated over the shorter of its useful life or the term of the obligation.

If we do not control the building after the construction period ends, the assets and liabilities for construction costs are derecognized, and we classify the lease as either operating or finance.

Digital Video and Music Content

We obtain video content, inclusive of episodic television and movies, and music content for customers through licensing agreements that have a wide range of licensing provisions including both fixed and variable payment schedules. When the license fee for a specific video or music title is determinable or reasonably estimable and the content is available to us, we recognize an asset and a corresponding liability for the amounts owed. We reduce the liability as payments are made and we amortize the asset to "Cost of sales" on an accelerated basis, based on estimated usage or viewing patterns, or on a straight-line basis. If the licensing fee is not determinable or reasonably estimable, no asset or liability is recorded and licensing costs are expensed as incurred. We also develop original video content for which the production costs are capitalized and amortized to "Cost of sales" predominantly on an accelerated basis that follows the viewing patterns associated with the content. The weighted average remaining life of our capitalized video content is 2.6 years.

Our produced and licensed video content is primarily monetized together as a unit, referred to as a film group, in each major geography where we offer Amazon Prime memberships. These film groups are evaluated for impairment whenever an event occurs or circumstances change indicating the fair value is less than the carrying value. The total capitalized costs of video, which is primarily released content, and music as of December 31, 2018 and March 31, 2019 were \$3.8 billion and \$4.2 billion. Total video and music expense was \$1.5 billion and \$1.7 billion in Q1 2018 and Q1 2019. Total video and music expense includes licensing and production costs associated with content offered within Amazon Prime memberships, and costs associated with digital subscriptions and sold or rented content.

Unearned Revenue

Unearned revenue is recorded when payments are received or due in advance of performing our service obligations and is recognized over the service period. Unearned revenue primarily relates to prepayments of AWS services and Amazon Prime memberships. Our total unearned revenue as of December 31, 2018 was \$7.9 billion, of which \$2.8 billion was recognized as revenue during the three months ended March 31, 2019. Included in "Other long-term liabilities" on our consolidated balance sheets was \$1.4 billion of unearned revenue as of December 31, 2018 and March 31, 2019.

Additionally, we have performance obligations, primarily related to AWS, associated with commitments in customer contracts for future services that have not yet been recognized in our financial statements. For contracts with original terms that exceed one year, those commitments not yet recognized were \$21.6 billion as of March 31, 2019. The weighted average remaining life of our long-term contracts is 3.3 years. However, the amount and timing of revenue recognition is largely driven by customer usage, which can extend beyond the original contractual term.

Accounting Pronouncements Recently Adopted

In February 2016, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standards Update (“ASU”) amending the accounting for leases, primarily requiring the recognition of lease assets and liabilities for operating leases with terms of more than twelve months on our consolidated balance sheets. Under the new guidance, leases previously described as capital lease obligations and finance lease obligations are now referred to as finance leases and financing obligations, respectively. We adopted this ASU on January 1, 2019 by recording an immaterial cumulative adjustment to retained earnings rather than retrospectively adjusting prior periods. Prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting policies resulting in a balance sheet presentation that is not comparable to the prior period in the first year of adoption. The adoption of this ASU resulted in the recognition of operating lease assets and liabilities of approximately \$21 billion, which included the reclassification of finance lease obligations to operating leases of \$1.2 billion. As of December 31, 2018, amounts related to finance lease obligations and construction liabilities totaled \$9.6 billion, of which \$1.5 billion was derecognized for buildings that we do not control during the construction period and \$5.4 billion and \$1.5 billion were reclassified to finance leases and operating leases, respectively.

In March 2019, the FASB issued an ASU amending the accounting for film costs, inclusive of episodic television and movie costs. The new guidance aligns the accounting for production costs of episodic television with that of movies by requiring production costs to be capitalized. Previously, we only capitalized a portion of the production costs related to our produced episodic television content. We adopted this ASU as of January 1, 2019 and began capitalizing substantially all of our production costs. Adoption of this ASU resulted in approximately \$130 million of incremental capitalized film costs classified in “Other Assets” for the period ended March 31, 2019.

Note 2 — FINANCIAL INSTRUMENTS

Cash, Cash Equivalents, Restricted Cash, and Marketable Securities

As of December 31, 2018 and March 31, 2019, our cash, cash equivalents, restricted cash, and marketable securities primarily consisted of cash, AAA-rated money market funds, U.S. and foreign government and agency securities, and other investment grade securities. Cash equivalents and marketable securities are recorded at fair value. 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.

We measure the fair value of money market funds and certain marketable equity securities based on quoted prices in active markets for identical assets or liabilities. Other marketable securities were valued either based on recent trades of securities in inactive markets or based on quoted market prices of similar instruments and other significant inputs derived from or corroborated by observable market data. We did not hold any cash, cash equivalents, restricted cash, or marketable securities categorized as Level 3 assets as of December 31, 2018 and March 31, 2019.

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

	December 31, 2018	March 31, 2019			
	Total Estimated Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Estimated Fair Value
Cash	\$ 10,406	\$ 8,635	\$ —	\$ —	\$ 8,635
Level 1 securities:					
Money market funds	12,515	9,515	—	—	9,515
Equity securities (1)	170				263
Level 2 securities:					
Foreign government and agency securities	815	1,382	—	—	1,382
U.S. government and agency securities	11,667	8,864	3	(13)	8,854
Corporate debt securities	4,990	7,396	8	(6)	7,398
Asset-backed securities	892	1,166	3	(2)	1,167
Other fixed income securities	188	201	—	(1)	200
Equity securities (1)	33				—
	<u>\$ 41,676</u>	<u>\$ 37,159</u>	<u>\$ 14</u>	<u>\$ (22)</u>	<u>\$ 37,414</u>
Less: Restricted cash, cash equivalents, and marketable securities (2)	(426)				(394)
Total cash, cash equivalents, and marketable securities	<u>\$ 41,250</u>				<u>\$ 37,020</u>

(1) The related unrealized gain (loss) recorded in “Other income (expense), net” was \$68 million in Q1 2019.

(2) We are required to pledge or otherwise restrict a portion of our cash, cash equivalents, and marketable securities as collateral for real estate leases, amounts due to third-party sellers in certain jurisdictions, debt, and standby and trade letters of credit. We classify cash, cash equivalents, and marketable securities with use restrictions of less than twelve months as “Accounts receivable, net and other” and 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 the remaining contractual maturities of our cash equivalents and marketable fixed income securities as of March 31, 2019 (in millions):

	Amortized Cost	Estimated Fair Value
Due within one year	\$ 23,482	\$ 23,478
Due after one year through five years	4,274	4,277
Due after five years through ten years	190	190
Due after ten years	578	571
Total	<u>\$ 28,524</u>	<u>\$ 28,516</u>

Actual maturities may differ from the contractual maturities because borrowers may have certain prepayment conditions.

Equity Warrants and Non-Marketable Equity Securities

We hold equity warrants giving us the right to acquire stock of other companies. As of December 31, 2018 and March 31, 2019, these warrants had a fair value of \$440 million and \$594 million, and are recorded within “Other assets” on our consolidated balance sheets. The related gain (loss) recorded in “Other income (expense), net” was \$45 million and \$89 million in Q1 2018 and Q1 2019. These assets are primarily classified as Level 2 assets.

As of December 31, 2018 and March 31, 2019, equity securities not accounted for under the equity method and without readily determinable fair values, had a carrying value of \$282 million and \$888 million.

Consolidated Statements of Cash Flows Reconciliation

The following table provides a reconciliation of the amount of cash, cash equivalents, and restricted cash reported within the consolidated balance sheets to the total of the same such amounts shown in the consolidated statements of cash flows (in millions):

	December 31, 2018	March 31, 2019
Cash and cash equivalents	\$ 31,750	\$ 23,115
Restricted cash included in accounts receivable, net and other	418	359
Restricted cash included in other assets	5	33
Total cash, cash equivalents, and restricted cash shown in the consolidated statements of cash flows	\$ 32,173	\$ 23,507

Note 3 — LEASES

Gross assets recorded under finance leases, included in “Property and equipment, net,” were \$36.1 billion and \$46.5 billion as of December 31, 2018 and March 31, 2019. Accumulated amortization associated with finance leases was \$19.8 billion and \$23.0 billion as of December 31, 2018 and March 31, 2019.

Lease cost recognized in our consolidated statements of operations is summarized as follows (in millions):

	Three Months Ended March 31, 2019
Operating lease cost (1)	\$ 836
Finance lease cost:	
Amortization of lease assets	2,307
Interest on lease liabilities	156
Finance lease cost	2,463
Variable lease cost	250
Total lease cost	\$ 3,549

(1) Rental expense under operating lease agreements was \$791 million for Q1 2018.

Other information about lease amounts recognized in our consolidated financial statements is summarized as follows:

	March 31, 2019
Weighted-average remaining lease term – operating leases	11.4 years
Weighted-average remaining lease term – finance leases	5.7 years
Weighted-average discount rate – operating leases	3.2%
Weighted-average discount rate – finance leases	2.9%

As of March 31, 2019, our lease liabilities were as follows (in millions):

	Operating Leases	Finance Leases	Total
Gross lease liabilities	\$ 26,731	\$ 25,004	\$ 51,735
Less: imputed interest	(5,850)	(1,810)	(7,660)
Present value of lease liabilities	20,881	23,194	44,075
Less: current portion of lease liabilities	(2,490)	(8,310)	(10,800)
Total long-term lease liabilities	\$ 18,391	\$ 14,884	\$ 33,275

Note 4 — COMMITMENTS AND CONTINGENCIES

Commitments

We have entered into non-cancellable operating and finance leases and financing obligations for equipment and office, fulfillment, sortation, delivery, data center, physical store, and renewable energy facilities.

The following summarizes our principal contractual commitments, excluding open orders for purchases that support normal operations and are generally cancellable, as of March 31, 2019 (in millions):

	Nine Months Ended December 31,	Year Ended December 31,					
	2019	2020	2021	2022	2023	Thereafter	Total
Debt principal and interest	\$ 1,992	\$ 2,161	\$ 1,874	\$ 2,090	\$ 1,794	\$ 30,014	\$ 39,925
Operating leases	2,355	3,077	2,794	2,473	2,214	13,818	26,731
Finance lease liabilities, including interest	6,247	7,268	4,218	1,444	1,022	4,805	25,004
Financing obligations, including interest	15	23	23	24	24	313	422
Unconditional purchase obligations (1)	2,272	3,845	3,314	3,057	2,931	5,148	20,567
Other commitments (2) (3)	2,409	2,154	1,450	1,188	1,015	10,451	18,667
Total commitments	\$ 15,290	\$ 18,528	\$ 13,673	\$ 10,276	\$ 9,000	\$ 64,549	\$ 131,316

- (1) Includes unconditional purchase obligations related to certain products offered in our Whole Foods Market stores and long-term agreements to acquire and license digital media content that are not reflected on the consolidated balance sheets. For those digital media content agreements with variable terms, we do not estimate the total obligation beyond any minimum quantities and/or pricing as of the reporting date. Purchase obligations associated with renewal provisions solely at the option of the content provider are included to the extent such commitments are fixed or a minimum amount is specified.
- (2) Includes the estimated timing and amounts of payments for rent and tenant improvements associated with build-to-suit lease arrangements and lease arrangements prior to the lease commencement date and digital media content liabilities associated with long-term digital media content assets with initial terms greater than one year.
- (3) Excludes approximately \$3.6 billion of accrued tax contingencies for which we cannot make a reasonably reliable estimate of the amount and period of payment, if any.

Pledged Assets

As of December 31, 2018 and March 31, 2019, we have pledged or otherwise restricted \$575 million and \$609 million of our cash, cash equivalents, and marketable securities, and certain property and equipment as collateral for real estate leases, amounts due to third-party sellers in certain jurisdictions, debt, and standby and trade letters of credit.

Other Contingencies

In 2016, we determined that we processed and delivered orders of consumer products for certain individuals and entities located outside Iran covered by the Iran Threat Reduction and Syria Human Rights Act or other United States sanctions and export control laws. The consumer products included books, music, other media, apparel, home and kitchen, health and beauty, jewelry, office, consumer electronics, software, lawn and patio, grocery, and automotive products. Our review is ongoing and we have voluntarily reported these orders to the United States Treasury Department's Office of Foreign Assets Control and the United States Department of Commerce's Bureau of Industry and Security. We intend to cooperate fully with OFAC and BIS with respect to their review, which may result in the imposition of penalties. For additional information, see Item 5 of Part II, "Other Information — Disclosure Pursuant to Section 13(r) of the Exchange Act."

We are subject to claims related to various indirect taxes (such as sales, value added, consumption, service, and similar taxes), including in jurisdictions in which we already collect and remit such taxes. If the relevant taxing authorities were successfully to pursue these claims, we could be subject to significant additional tax liabilities. For example, in June 2017, the State of South Carolina issued an assessment for uncollected sales and use taxes for the period from January 2016 to March 2016, including interest and penalties. South Carolina is alleging that we should have collected sales and use taxes on transactions by our third-party sellers. We believe the assessment is without merit. If South Carolina or other states were successfully to seek additional adjustments of a similar nature, we could be subject to significant additional tax liabilities. We intend to defend ourselves vigorously in this matter.

Legal Proceedings

The Company is involved from time to time in claims, proceedings, and litigation, including the matters described in Item 8 of Part II, “Financial Statements and Supplementary Data — Note 7 — Commitments and Contingencies — Legal Proceedings” of our 2018 Annual Report on Form 10-K as supplemented by the following:

In November 2018, Dynamic Data Technologies, LLC filed a complaint for patent infringement against Amazon.com, Inc., Amazon Web Services, Inc., and Amazon Digital Services, LLC in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that products and services with H.265 functionality, including Amazon Elastic Transcoder, AWS Elemental Media Convert, AWS Elemental MediaLive, certain EC2 instances, Amazon CloudFront, Amazon Fire TV, and Amazon Fire tablets, infringe U.S. Patent Nos. 8,135,073, entitled “Enhancing Video Images Depending On Prior Image Enhancements”; 6,774,918, entitled “Video Overlay Processor With Reduced Memory And Bus Performance Requirements”; and 7,571,450, entitled “System For And Method Of Displaying Information.” The complaint also alleges that products and services with H.265 functionality, including AWS Elemental Media Convert, AWS Elemental MediaLive, certain EC2 instances, Amazon CloudFront, and Amazon Fire TV, infringe U.S. Patent Nos. 8,073,054, entitled “Unit For And Method Of Estimating A Current Motion Vector”; 6,996,177, entitled “Motion Estimation”; 8,311,112, entitled “System And Method For Video Compression Using Predictive Coding”; and 7,894,529, entitled “Method And Device For Determining Motion Vectors.” The complaint also alleges that products and services for encoding video data, including Amazon Elastic Transcoder and Amazon Video, infringe U.S. Patent No. 8,184,689, entitled “Method Video Encoding And Decoding Preserving Cache Localities,” and that products and services with VP9 encoding functionality, including Amazon Elastic Transcoder and Amazon Fire TV, infringe U.S. Patent No. 7,519,230, entitled “Background Motion Vector Detection.” In February 2019, Dynamic Data Technologies filed an amended complaint. The amended complaint adds allegations that products and services with H.265 image encoding functionality, including Amazon Elastic Transcoder, AWS Elemental Media Convert, AWS Elemental MediaLive, and Amazon Fire TV, infringe U.S. Patent No. 6,639,944, entitled “Sub-Pixel Accurate Motion Vector Estimation And Compensated Interpolation.” The amended complaint also adds allegations that products and services with H.265 functionality, including AWS Elemental Media Convert, AWS Elemental MediaLive, certain EC2 instances, Amazon CloudFront, and Amazon Fire TV, infringe U.S. Patent Nos. 6,782,054, entitled “Method And Apparatus For Motion Vector Estimation,” and 7,010,039, entitled “Motion Estimator For Reduced Halos In MC Up-Conversion.” The amended complaint also adds allegations that products and services with H.265 functionality, including Amazon Elastic Transcoder, AWS Elemental Media Convert, AWS Elemental MediaLive, certain EC2 instances, Amazon CloudFront, Amazon Fire TV, and Amazon Fire tablets, infringe U.S. Patent No. 8,189,105, entitled “Systems And Methods Of Motion And Edge Adaptive Processing Including Motion Compensation Features,” and that products and services with VP9 image processing functionality, including Amazon Elastic Transcoder and Amazon Fire TV, infringe U.S. Patent No. 7,058,227, entitled “Problem Area Location In An Image Signal.” The amended complaint seeks an unspecified amount of damages, enhanced damages, and attorneys’ fees. We dispute the allegations of wrongdoing and intend to defend ourselves vigorously in this matter.

In January 2019, Saint Lawrence Communications, LLC filed a complaint against Amazon.com, Inc. and Amazon.com LLC in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that voice encoding functionality in Amazon devices infringes U.S. Patent Nos. 6,795,805, entitled “Periodicity Enhancement In Decoding Wideband Signals”; 6,807,524, entitled “Perceptual Weighting Device And Method For Efficient Coding Of Wideband Signals”; 7,151,802, entitled “High Frequency Content Recovering Method And Device For Over-Sampled Synthesized Wideband Signal”; 7,191,123, entitled “Gain-Smoothing In Wideband Speech And Audio Signal Decoder”; and 7,260,521, entitled “Method And Device For Adaptive Bandwidth Pitch Search In Coding Wideband Signals.” The complaint seeks an unspecified amount of damages, enhanced damages, attorneys’ fees, costs, and interest. We dispute the allegations of wrongdoing and intend to defend ourselves vigorously in this matter.

In March 2019, Data Scape, LLC filed a petition with the United States International Trade Commission requesting that the International Trade Commission commence an investigation into the sale of certain Amazon-branded devices, including Kindle e-readers, Fire tablets, FireTV devices, and the Echo Spot and Echo Show (“accused devices”). Data Scape’s petition alleges that, when used on the accused devices, Amazon Photo, Amazon Drive, Amazon Music, and book delivery infringe U.S. Patent Nos. 7,720,929; 7,617,537; and 8,386,581, each entitled “Communication System And Its Method And Communication Apparatus And Its Method.” Data Scape is seeking a general exclusion order preventing the importation of the accused devices into the United States. We dispute the allegations of wrongdoing and intend to defend ourselves vigorously in this matter.

In April 2019, Vocalife LLC filed a complaint against Amazon.com, Inc. and Amazon.com LLC in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that Amazon Echo devices infringe U.S. Patent No. RE47,049, entitled “Microphone Array System.” The complaint seeks injunctive relief, an unspecified amount of damages, attorneys’ fees, costs, and interest. We dispute the allegations of wrongdoing and intend to defend ourselves vigorously in this matter.

The outcomes of our legal proceedings and other contingencies are inherently unpredictable, subject to significant uncertainties, and could be material to our operating results and cash flows for a particular period. In addition, for the matters we disclose that do not include an estimate of the amount of loss or range of losses, such an estimate is not possible or is immaterial, and we may be unable to estimate the possible loss or range of losses that could potentially result from the application of non-monetary remedies.

See also “Note 7 — Income Taxes.”

Note 5 — DEBT

As of March 31, 2019, we had \$24.3 billion of unsecured senior notes outstanding (the “Notes”). As of December 31, 2018 and March 31, 2019, the net unamortized discount and debt issuance costs on the Notes was \$101 million. We also have other long-term debt with a carrying amount, including the current portion and borrowings under our credit facility, of \$715 million and \$781 million as of December 31, 2018 and March 31, 2019. The face value of our total long-term debt obligations is as follows (in millions):

	December 31, 2018	March 31, 2019
2.600% Notes due on December 5, 2019 (2)	1,000	1,000
1.900% Notes due on August 21, 2020 (3)	1,000	1,000
3.300% Notes due on December 5, 2021 (2)	1,000	1,000
2.500% Notes due on November 29, 2022 (1)	1,250	1,250
2.400% Notes due on February 22, 2023 (3)	1,000	1,000
2.800% Notes due on August 22, 2024 (3)	2,000	2,000
3.800% Notes due on December 5, 2024 (2)	1,250	1,250
5.200% Notes due on December 3, 2025 (4)	1,000	1,000
3.150% Notes due on August 22, 2027 (3)	3,500	3,500
4.800% Notes due on December 5, 2034 (2)	1,250	1,250
3.875% Notes due on August 22, 2037 (3)	2,750	2,750
4.950% Notes due on December 5, 2044 (2)	1,500	1,500
4.050% Notes due on August 22, 2047 (3)	3,500	3,500
4.250% Notes due on August 22, 2057 (3)	2,250	2,250
Credit Facility	594	539
Other long-term debt	121	242
Total debt	24,965	25,031
Less current portion of long-term debt	(1,371)	(1,608)
Face value of long-term debt	\$ 23,594	\$ 23,423

(1) Issued in November 2012, effective interest rate of the 2022 Notes was 2.66%.

(2) Issued in December 2014, effective interest rates of the 2019, 2021, 2024, 2034, and 2044 Notes were 2.73%, 3.43%, 3.90%, 4.92%, and 5.11%.

(3) Issued in August 2017, effective interest rates of the 2020, 2023, 2024, 2027, 2037, 2047, and 2057 Notes were 2.16%, 2.56%, 2.95%, 3.25%, 3.94%, 4.13%, and 4.33%.

(4) Consists of \$872 million of 2025 Notes issued in December 2017 in exchange for notes assumed in connection with the acquisition of Whole Foods Market and \$128 million of 2025 Notes issued by Whole Foods Market that did not participate in our December 2017 exchange offer. The effective interest rate of the 2025 Notes was 3.02%.

Interest on the Notes issued in 2012 is payable semi-annually in arrears in May and November. Interest on the Notes issued in 2014 is payable semi-annually in arrears in June and December. Interest on the Notes issued in 2017 is payable semi-annually in arrears in February and August. Interest on the 2025 Notes is payable semi-annually in arrears in June and December. We may redeem the Notes at any time in whole, or from time to time, in part at specified redemption prices. We are not subject to any financial covenants under the Notes. The proceeds from the November 2012 and the December 2014 Notes were used for general corporate purposes. The proceeds from the August 2017 Notes were used to fund the consideration for the acquisition of Whole Foods Market, to repay notes due in 2017, and for general corporate purposes. The estimated fair value of the Notes was approximately \$24.3 billion and \$25.5 billion as of December 31, 2018 and March 31, 2019, which is based on Level 2 inputs.

In October 2016, we entered into a \$500 million secured revolving credit facility with a lender that is secured by certain seller receivables, which we subsequently increased to \$620 million and may from time to time increase in the future subject to lender approval (the “Credit Facility”). The Credit Facility is available for a term of three years, bears interest at the London interbank offered rate (“LIBOR”) plus 1.65%, and has a commitment fee of 0.50% on the undrawn portion. There were \$594 million and \$539 million of borrowings outstanding under the Credit Facility as of December 31, 2018 and March 31, 2019, with weighted-average interest rates of 3.2% and 3.3% as of December 31, 2018 and March 31, 2019. As of December 31, 2018 and March 31, 2019, we have pledged \$686 million and \$630 million of our cash and seller receivables as collateral for debt related to our Credit Facility. The estimated fair value of the Credit Facility, which is based on Level 2 inputs, approximated its carrying value as of December 31, 2018 and March 31, 2019.

Other long-term debt, including the current portion, had a weighted-average interest rate of 6.0% and 5.5% as of December 31, 2018 and March 31, 2019. We used the net proceeds from the issuance of this debt primarily to fund certain business operations. The estimated fair value of other long-term debt, which is based on Level 2 inputs, approximated its carrying value as of December 31, 2018 and March 31, 2019.

In April 2018, we established a commercial paper program (the “Commercial Paper Program”) under which we may from time to time issue unsecured commercial paper up to a total of \$7.0 billion at any time, with individual maturities that may vary but will not exceed 397 days from the date of issue. There were no borrowings outstanding under the Commercial Paper Program as of December 31, 2018 and March 31, 2019.

In April 2018, in connection with our Commercial Paper Program, we amended and restated our unsecured revolving credit facility (the “Credit Agreement”) with a syndicate of lenders to increase our borrowing capacity thereunder to \$7.0 billion. As amended and restated, the Credit Agreement has a term of three years, but it may be extended for up to three additional one-year terms if approved by the lenders. The interest rate applicable to outstanding balances under the amended and restated Credit Agreement is LIBOR plus 0.50%, with a commitment fee of 0.04% on the undrawn portion of the credit facility. There were no borrowings outstanding under the Credit Agreement as of December 31, 2018 and March 31, 2019.

Note 6 — STOCKHOLDERS’ EQUITY

Stock Repurchase Activity

In February 2016, the Board of Directors authorized a program to repurchase up to \$5.0 billion of our common stock, with no fixed expiration. There were no repurchases of common stock in Q1 2018 or Q1 2019.

Stock Award Activity

Common shares outstanding plus shares underlying outstanding stock awards totaled 507 million as of December 31, 2018 and March 31, 2019. These totals include all vested and unvested stock awards outstanding, including those awards we estimate will be forfeited. Stock-based compensation expense is as follows (in millions):

	Three Months Ended March 31,	
	2018	2019
Cost of sales	\$ 15	\$ 24
Fulfillment	244	234
Marketing	161	209
Technology and content	631	675
General and administrative	132	132
Total stock-based compensation expense	<u>\$ 1,183</u>	<u>\$ 1,274</u>

The following table summarizes our restricted stock unit activity for the three months ended March 31, 2019 (in millions):

	Number of Units	Weighted-Average Grant-Date Fair Value
Outstanding as of December 31, 2018	15.9	\$ 1,024
Units granted	0.6	1,677
Units vested	(1.2)	627
Units forfeited	(0.4)	1,023
Outstanding as of March 31, 2019	<u>14.9</u>	<u>\$ 1,080</u>

Scheduled vesting for outstanding restricted stock units as of March 31, 2019, is as follows (in millions):

	Nine Months Ended December 31,	Year Ended December 31,					Thereafter	Total
	2019	2020	2021	2022	2023			
Scheduled vesting—restricted stock units	5.6	5.5	2.5	1.0	0.2		0.1	14.9

As of March 31, 2019, there was \$6.1 billion of net unrecognized compensation cost related to unvested stock-based compensation arrangements. This compensation is recognized on an accelerated basis with approximately half of the compensation expected to be expensed in the next twelve months, and has a weighted-average recognition period of 1.1 years. The estimated forfeiture rate as of December 31, 2018 and March 31, 2019 was 27%. Changes in our estimates and assumptions relating to forfeitures may cause us to realize material changes in stock-based compensation expense in the future.

Changes in Stockholders' Equity

The following table shows the changes in stockholders' equity (in millions):

	Three Months Ended March 31,	
	2018	2019
Total beginning stockholders' equity	\$ 27,709	\$ 43,549
Beginning and ending common stock	5	5
Beginning and ending treasury stock	(1,837)	(1,837)
Beginning additional paid-in capital	21,389	26,791
Stock-based compensation and issuance of employee benefit plan stock	1,174	1,268
Ending additional paid-in capital	22,563	28,059
Beginning accumulated other comprehensive loss	(484)	(1,035)
Other comprehensive income (loss)	17	25
Ending accumulated other comprehensive loss	(467)	(1,010)
Beginning retained earnings	8,636	19,625
Cumulative effect of changes in accounting principles (1)	934	7
Net income	1,629	3,561
Ending retained earnings	11,199	23,193
Total ending stockholders' equity	\$ 31,463	\$ 48,410

(1) We recorded cumulative effect adjustments related to the new revenue and income tax standards in Q1 2018 and the new lease standard in Q1 2019. See Item 1 of Part I, "Financial Statements — Note 1 — Accounting Policies — Accounting Pronouncements Recently Adopted" for additional information.

Note 7 — INCOME TAXES

Our tax provision or benefit from income taxes for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes, we make a cumulative adjustment.

Our quarterly tax provision, and our quarterly estimate of our annual effective tax rate, is subject to significant variation due to several factors, including variability in accurately predicting our pre-tax and taxable income and loss and the mix of jurisdictions to which they relate, intercompany transactions, the applicability of special tax regimes, changes in how we do business, acquisitions, investments, audit-related developments, changes in our stock price, changes in our deferred tax assets and liabilities and their valuation, foreign currency gains (losses), changes in statutes, regulations, case law, and administrative

practices, principles, and interpretations related to tax, including changes to the global tax framework, competition, and other laws and accounting rules in various jurisdictions, and relative changes of expenses or losses for which tax benefits are not recognized. Additionally, our effective tax rate can be more or less volatile based on the amount of pre-tax income or loss. For example, the impact of discrete items and non-deductible expenses on our effective tax rate is greater when our pre-tax income is lower.

For 2019, we estimate that our effective tax rate will be favorably affected by the impact of excess tax benefits from stock-based compensation and the U.S. federal research and development credit and adversely affected by state income taxes and losses incurred in certain foreign jurisdictions for which we may not realize a tax benefit. Losses for which we may not realize a related tax benefit, primarily due to losses of foreign subsidiaries, reduce our pre-tax income without a corresponding reduction in our tax expense, and therefore increase our effective tax rate. We record valuation allowances against the deferred tax assets associated with losses for which we may not realize a related tax benefit.

Our income tax provisions for the three months ended March 31, 2018 and March 31, 2019 were \$287 million and \$836 million, which included \$368 million and \$261 million of net discrete tax benefits primarily attributable to excess tax benefits from stock-based compensation.

Cash paid for income taxes, net of refunds was \$513 million and \$168 million in Q1 2018 and Q1 2019.

As of December 31, 2018 and March 31, 2019, tax contingencies were approximately \$3.4 billion and \$3.6 billion. We expect the total amount of tax contingencies will grow in 2019. In addition, changes in state, federal, and foreign tax laws may increase our tax contingencies. The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ from the amounts accrued. It is reasonably possible that within the next twelve months we will receive additional assessments by various tax authorities or possibly reach resolution of income tax examinations in one or more jurisdictions. These assessments or settlements could result in changes to our contingencies related to positions on tax filings on prior years' tax filings.

We are under examination, or may be subject to examination, by the Internal Revenue Service ("IRS") for the calendar year 2005 and thereafter. These examinations may lead to ordinary course adjustments or proposed adjustments to our taxes or our net operating losses with respect to years under examination as well as subsequent periods. As previously disclosed, we have received Notices of Proposed Adjustment ("NOPAs") from the IRS for transactions undertaken in the 2005 and 2006 calendar years relating to transfer pricing with our foreign subsidiaries. The IRS is seeking to increase our U.S. taxable income by an amount that would result in additional federal tax of approximately \$1.5 billion, subject to interest. On March 23, 2017, the U.S. Tax Court issued its decision regarding the issues raised in the IRS NOPAs. The Tax Court rejected the approach from the IRS NOPAs in determining transfer pricing adjustments in 2005 and 2006 for the transactions undertaken with our foreign subsidiaries and adopted, with adjustments, our suggested approach. In September 2017, the IRS appealed the decision to the U.S. Court of Appeals for the Ninth Circuit. We will continue to defend ourselves vigorously in this matter. If the Tax Court decision were reversed on appeal or if the IRS were to successfully assert transfer pricing adjustments of a similar nature to the NOPAs for transactions in subsequent years, we could be subject to significant additional tax liabilities.

In October 2014, the European Commission opened a formal investigation to examine whether decisions by the tax authorities in Luxembourg with regard to the corporate income tax paid by certain of our subsidiaries comply with European Union rules on state aid. On October 4, 2017, the European Commission announced its decision that determinations by the tax authorities in Luxembourg did not comply with European Union rules on state aid. Based on that decision the European Commission announced an estimated recovery amount of approximately €250 million, plus interest, for the period May 2006 through June 2014, and ordered Luxembourg tax authorities to calculate the actual amount of additional taxes subject to recovery. Luxembourg computed an initial recovery amount, consistent with the European Commission's decision, that we deposited into escrow in March 2018, subject to adjustment pending conclusion of all appeals. In December 2017, Luxembourg appealed the European Commission's decision. In May 2018, we appealed. We believe the European Commission's decision to be without merit and will continue to defend ourselves vigorously in this matter. We are also subject to taxation in various states and other foreign jurisdictions including China, Germany, India, Japan, Luxembourg, and the United Kingdom. We are under, or may be subject to, audit or examination and additional assessments by the relevant authorities in respect of these particular jurisdictions primarily for 2008 and thereafter.

Note 8 — SEGMENT INFORMATION

We have organized our operations into three segments: North America, International, and AWS. We allocate to segment results the operating expenses "Fulfillment," "Marketing," "Technology and content," and "General and administrative" based on usage, which is generally reflected in the segment in which the costs are incurred. The majority of technology infrastructure costs are allocated to the AWS segment based on usage. The majority of the remaining non-infrastructure technology costs are incurred in the U.S. and are allocated to our North America segment. There are no internal revenue transactions between our reportable segments. These segments reflect the way our chief operating decision maker evaluates the Company's business performance and manages its operations.

North America

The North America segment primarily consists of amounts earned from retail sales of consumer products (including from sellers) and subscriptions through North America-focused online and physical stores. This segment includes export sales from these online stores.

International

The International segment primarily consists of amounts earned from retail sales of consumer products (including from sellers) and subscriptions through internationally-focused online stores. This segment includes export sales from these internationally-focused online stores (including export sales from these online stores to customers in the U.S., Mexico, and Canada), but excludes export sales from our North America-focused online stores.

AWS

The AWS segment consists of amounts earned from global sales of compute, storage, database, and other service offerings for start-ups, enterprises, government agencies, and academic institutions.

Information on reportable segments and reconciliation to consolidated net income is as follows (in millions):

	Three Months Ended March 31,	
	2018	2019
North America		
Net sales	\$ 30,725	\$ 35,812
Operating expenses	29,576	33,525
Operating income	\$ 1,149	\$ 2,287
International		
Net sales	\$ 14,875	\$ 16,192
Operating expenses	15,497	16,282
Operating income (loss)	\$ (622)	\$ (90)
AWS		
Net sales	\$ 5,442	\$ 7,696
Operating expenses	4,042	5,473
Operating income	\$ 1,400	\$ 2,223
Consolidated		
Net sales	\$ 51,042	\$ 59,700
Operating expenses	49,115	55,280
Operating income	1,927	4,420
Total non-operating income (expense)	(11)	(19)
Provision for income taxes	(287)	(836)
Equity-method investment activity, net of tax	—	(4)
Net income	\$ 1,629	\$ 3,561

Net sales by groups of similar products and services, which also have similar economic characteristics, is as follows (in millions):

	Three Months Ended March 31,	
	2018	2019
Net Sales:		
Online stores (1)	\$ 26,939	\$ 29,498
Physical stores (2)	4,263	4,307
Third-party seller services (3)	9,265	11,141
Subscription services (4)	3,102	4,342
AWS	5,442	7,696
Other (5)	2,031	2,716
Consolidated	<u>\$ 51,042</u>	<u>\$ 59,700</u>

- (1) Includes product sales and digital media content where we record revenue gross. We leverage our retail infrastructure to offer a wide selection of consumable and durable goods that includes media products available in both a physical and digital format, such as books, music, videos, games, and software. These product sales include digital products sold on a transactional basis. Digital product subscriptions that provide unlimited viewing or usage rights are included in Subscription services.
- (2) Includes product sales where our customers physically select items in a store.
- (3) Includes commissions and any related fulfillment and shipping fees, and other third-party seller services.
- (4) Includes annual and monthly fees associated with Amazon Prime memberships, as well as audiobook, digital video, e-book, digital music, and other non-AWS subscription services.
- (5) Primarily includes sales of advertising services, as well as sales related to our other service offerings.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations***Forward-Looking Statements***

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding guidance, industry prospects, or future results of operations or financial position, made in this Quarterly Report on Form 10-Q are forward-looking. We use words such as anticipates, believes, expects, future, intends, and similar expressions to identify forward-looking statements. Forward-looking statements reflect management's current expectations and are inherently uncertain. Actual results could differ materially for a variety of reasons, including, among others, fluctuations in foreign exchange rates, changes in global economic conditions and customer spending, world events, the rate of growth of the Internet, online commerce, and cloud services, the amount that Amazon.com invests in new business opportunities and the timing of those investments, the mix of products and services sold to customers, the mix of net sales derived from products as compared with services, the extent to which we owe income or other taxes, competition, management of growth, potential fluctuations in operating results, international growth and expansion, the outcomes of legal proceedings and claims, fulfillment, sortation, delivery, and data center optimization, risks of inventory management, seasonality, the degree to which we enter into, maintain, and develop commercial agreements, proposed and completed acquisitions and strategic transactions, payments risks, and risks of fulfillment throughput and productivity. In addition, the current global economic climate amplifies many of these risks. These risks and uncertainties, as well as other risks and uncertainties that could cause our actual results to differ significantly from management's expectations, are described in greater detail in Item 1A of Part II, "Risk Factors."

For additional information, see Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Overview" of our 2018 Annual Report on Form 10-K.

Critical Accounting Judgments

The preparation of financial statements in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. The SEC has defined a company's critical accounting policies as the ones that are most important to the portrayal of the company's financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified the critical accounting policies and judgments addressed below. We also have other key accounting policies, which involve the use of estimates, judgments, and assumptions that are significant to understanding our results. For additional information, see Item 8 of Part II, "Financial Statements and Supplementary Data — Note 1 — Description of Business and Accounting Policies," of our 2018 Annual Report on Form 10-K and Item 1 of Part I, "Financial Statements — Note 1 — Accounting Policies," of this Form 10-Q. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions.

Inventories

Inventories, consisting of products available for sale, are primarily accounted for using the first-in first-out method, and are valued at the lower of cost and net realizable value. This valuation requires us to make judgments, based on currently available information, about the likely method of disposition, such as through sales to individual customers, returns to product vendors, or liquidations, and expected recoverable values of each disposition category. These assumptions about future disposition of inventory are inherently uncertain and changes in our estimates and assumptions may cause us to realize material write-downs in the future. As a measure of sensitivity, for every 1% of additional inventory valuation allowance as of March 31, 2019, we would have recorded an additional cost of sales of approximately \$185 million.

In addition, we enter into supplier commitments for certain electronic device components and certain products. These commitments are based on forecasted customer demand. If we reduce these commitments, we may incur additional costs.

Income Taxes

We are subject to income taxes in the U.S. (federal and state) and numerous foreign jurisdictions. Tax laws, regulations, administrative practices, principles, and interpretations in various jurisdictions may be subject to significant change, with or without notice, due to economic, political, and other conditions, and significant judgment is required in evaluating and estimating our provision and accruals for these taxes. There are many transactions that occur during the ordinary course of business for which the ultimate tax determination is uncertain. Our effective tax rates could be affected by numerous factors, such as changes in our business operations, acquisitions, investments, entry into new businesses and geographies, intercompany transactions, the relative amount of our foreign earnings, including earnings being lower than anticipated in jurisdictions where

we have lower statutory rates and higher than anticipated in jurisdictions where we have higher statutory rates, losses incurred in jurisdictions for which we are not able to realize related tax benefits, the applicability of special tax regimes, changes in foreign currency exchange rates, changes in our stock price, changes in our deferred tax assets and liabilities and their valuation, changes in the laws, regulations, administrative practices, principles, and interpretations related to tax, including changes to the global tax framework, competition, and other laws and accounting rules in various jurisdictions. In addition, a number of countries are actively pursuing changes to their tax laws applicable to corporate multinationals, such as the U.S. tax reform legislation commonly known as the U.S. Tax Cuts and Jobs Act of 2017 (the “U.S. Tax Act”). Finally, foreign governments may enact tax laws in response to the U.S. Tax Act that could result in further changes to global taxation and materially affect our financial position and results of operations.

The U.S. Tax Act significantly changed how the U.S. taxes corporations. The U.S. Tax Act requires complex computations to be performed that were not previously required by U.S. tax law, significant judgments to be made in interpretation of the provisions of the U.S. Tax Act, significant estimates in calculations, and the preparation and analysis of information not previously relevant or regularly produced. The U.S. Treasury Department, the IRS, and other standard-setting bodies will continue to interpret or issue guidance on how provisions of the U.S. Tax Act will be applied or otherwise administered. As future guidance is issued, we may make adjustments to amounts that we have previously recorded that may materially impact our provision for income taxes in the period in which the adjustments are made.

We are also currently subject to tax controversies in various jurisdictions, and these jurisdictions may assess additional income tax liabilities against us. Developments in an audit, investigation, or other tax controversy could have a material effect on our operating results or cash flows in the period or periods for which that development occurs, as well as for prior and subsequent periods. We regularly assess the likelihood of an adverse outcome resulting from these proceedings to determine the adequacy of our tax accruals. Although we believe our tax estimates are reasonable, the final outcome of audits, investigations, and any other tax controversies could be materially different from our historical income tax provisions and accruals.

Recent Accounting Pronouncements

See Item 1 of Part I, “Financial Statements — Note 1 — Accounting Policies.”

Liquidity and Capital Resources

Cash flow information is as follows (in millions):

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2018	2019	2018	2019
Cash provided by (used in):				
Operating activities	\$ (1,791)	\$ 1,846	\$ 18,194	\$ 34,360
Investing activities	(533)	(8,123)	(26,265)	(19,959)
Financing activities	(2,164)	(2,377)	8,653	(7,899)

Our principal sources of liquidity are cash flows generated from operations and our cash, cash equivalents, and marketable securities balances, which, at fair value, were \$41.3 billion and \$37.0 billion as of December 31, 2018 and March 31, 2019. Amounts held in foreign currencies were \$13.8 billion and \$10.2 billion as of December 31, 2018 and March 31, 2019, and were primarily Euros, British Pounds, and Japanese Yen.

Cash provided by (used in) operating activities was \$(1.8) billion and \$1.8 billion for Q1 2018 and Q1 2019. Our operating cash flows result primarily from cash received from our consumer, seller, developer, enterprise, and content creator customers, and advertisers, offset by cash payments we make for products and services, employee compensation, payment processing and related transaction costs, operating leases, and interest payments on our long-term obligations. Cash received from our customers and other activities generally corresponds to our net sales. Because consumers primarily use credit cards to buy from us, our receivables from consumers settle quickly. The increase in operating cash flow for the trailing twelve months ended March 31, 2019, compared to the comparable prior year period, is primarily due to the increase in net income, excluding non-cash charges such as depreciation, amortization, and stock-based compensation. Cash provided by (used in) operating activities is also subject to changes in working capital. Working capital at any specific point in time is subject to many variables, including seasonality, inventory management and category expansion, the timing of cash receipts and payments, vendor payment terms, and fluctuations in foreign exchange rates.

Cash provided by (used in) investing activities corresponds with cash capital expenditures, including leasehold improvements, incentives received from property and equipment vendors, cash outlays for acquisitions, investments in other companies and intellectual property rights, and purchases, sales, and maturities of marketable securities. Cash provided by (used in) investing activities was \$(533) million and \$(8.1) billion for Q1 2018 and Q1 2019, with the variability caused primarily by our decision to purchase or lease property and equipment and purchases, maturities, and sales of marketable securities. Cash capital expenditures were \$2.7 billion during Q1 2018 and Q1 2019, which primarily reflect additional capacity to support our fulfillment operations and additional investments in support of continued business growth in technology infrastructure (the majority of which is to support AWS). We made cash payments, net of acquired cash, related to acquisition and other investment activity of \$13 million and \$1.2 billion during Q1 2018 and Q1 2019.

Cash provided by (used in) financing activities was \$(2.2) billion and \$(2.4) billion for Q1 2018 and Q1 2019. Cash outflows from financing activities result from principal repayments of finance leases and financing obligations and repayments of long-term debt and other and were \$2.3 billion and \$2.6 billion in Q1 2018 and Q1 2019. Property and equipment acquired under finance leases was \$2.3 billion and \$2.6 billion during Q1 2018 and Q1 2019, reflecting investments in support of continued business growth primarily due to investments in technology infrastructure for AWS, which investments we expect to continue over time.

We had no borrowings outstanding under the Commercial Paper Program or Credit Agreement and \$539 million of borrowings outstanding under our Credit Facility as of March 31, 2019. See Item 1 of Part I, “Financial Statements — Note 5 — Debt” for additional information.

We recorded net tax provisions of \$287 million and \$836 million in Q1 2018 and Q1 2019. Certain foreign subsidiary earnings are subject to U.S. taxation under the U.S. Tax Act, which also repeals U.S. taxation on the subsequent repatriation of those earnings. We intend to invest substantially all of our foreign subsidiary earnings, as well as our capital in our foreign subsidiaries, indefinitely outside of the U.S. in those jurisdictions in which we would incur significant, additional costs upon repatriation of such amounts.

We have tax benefits relating to excess stock-based compensation deductions and accelerated depreciation deductions that are being utilized to reduce our U.S. taxable income. The U.S. Tax Act enhanced and extended the option to claim accelerated depreciation deductions by allowing full expensing of qualified property, primarily equipment, through 2022. Cash taxes paid (net of refunds) were \$513 million and \$168 million for Q1 2018 and Q1 2019. As of December 31, 2018, our federal net operating loss carryforward was approximately \$627 million and we had approximately \$1.4 billion of federal tax credits potentially available to offset future tax liabilities. Our federal tax credits are primarily related to the U.S. federal research and development credit. As we utilize our federal net operating losses and tax credits we expect cash paid for taxes to increase. We

endeavor to manage our global taxes on a cash basis, rather than on a financial reporting basis. In connection with the European Commission’s October 2017 decision against us on state aid, Luxembourg tax authorities computed an initial recovery amount, consistent with the European Commission’s decision, of approximately €250 million, that we deposited into escrow in March 2018, subject to adjustment pending conclusion of all appeals.

Our liquidity is also affected by restricted cash balances that are pledged as collateral for real estate leases, amounts due to third-party sellers in certain jurisdictions, debt, and standby and trade letters of credit. To the extent we process payments for third-party sellers or offer certain types of stored value to our customers, some jurisdictions may restrict our use of those funds. These restrictions would result in the reclassification of a portion of our cash and cash equivalents from “Cash and cash equivalents” to restricted cash, which is classified within “Accounts receivable, net and other” and “Other assets” on our consolidated balance sheets. As of December 31, 2018 and March 31, 2019, restricted cash, cash equivalents, and marketable securities were \$426 million and \$394 million. See Item 1 of Part I, “Financial Statements — Note 4 — Commitments and Contingencies” and “Financial Statements — Note 5 — Debt” for additional discussion of our principal contractual commitments, as well as our pledged assets. Additionally, purchase obligations and open purchase orders, consisting of inventory and significant non-inventory commitments, were \$13.3 billion as of March 31, 2019. These purchase obligations and open purchase orders are generally cancellable in full or in part through the contractual provisions.

We believe that cash flows generated from operations and our cash, cash equivalents, and marketable securities balances, as well as our borrowing arrangements, will be sufficient to meet our anticipated operating cash needs for at least the next twelve months. However, any projections of future cash needs and cash flows are subject to substantial uncertainty. See Item 1A of Part II, “Risk Factors.” We continually evaluate opportunities to sell additional equity or debt securities, obtain credit facilities, obtain finance and operating lease arrangements, enter into financing obligations, repurchase common stock, pay dividends, or repurchase, refinance, or otherwise restructure our debt for strategic reasons or to further strengthen our financial position.

The sale of additional equity or convertible debt securities would likely be dilutive to our shareholders. In addition, we will, from time to time, consider the acquisition of, or investment in, complementary businesses, products, services, capital infrastructure, and technologies, which might affect our liquidity requirements or cause us to secure additional financing, or issue additional equity or debt securities. There can be no assurance that additional credit lines or financing instruments will be available in amounts or on terms acceptable to us, if at all.

Results of Operations

We have organized our operations into three segments: North America, International, and AWS. These segments reflect the way the Company evaluates its business performance and manages its operations. See Item 1 of Part I, “Financial Statements — Note 8 — Segment Information.”

Net Sales

Net sales include product and service sales. Product sales represent revenue from the sale of products and related shipping fees and digital media content where we record revenue gross. Service sales primarily represent third-party seller fees, which includes commissions and any related fulfillment and shipping fees, AWS sales, Amazon Prime membership fees, advertising services, and certain digital content subscriptions. Net sales information is as follows (in millions):

	Three Months Ended March 31,	
	2018	2019
Net Sales:		
North America	\$ 30,725	\$ 35,812
International	14,875	16,192
AWS	5,442	7,696
Consolidated	<u>\$ 51,042</u>	<u>\$ 59,700</u>
Year-over-year Percentage Growth:		
North America	46%	17%
International	34	9
AWS	49	41
Consolidated	43	17
Year-over-year Percentage Growth, excluding the effect of foreign exchange rates:		
North America	46%	17%
International	21	16
AWS	48	42
Consolidated	39	19
Net sales mix:		
North America	60%	60%
International	29	27
AWS	11	13
Consolidated	<u>100%</u>	<u>100%</u>

Sales increased 17% in Q1 2019 compared to the comparable prior year period. Changes in foreign currency exchange rates impacted net sales by \$(1.1) billion for Q1 2019. For a discussion of the effect on sales growth of foreign exchange rates, see “Effect of Foreign Exchange Rates” below.

North America sales increased 17% in Q1 2019 compared to the comparable prior year period. The sales growth primarily reflects increased unit sales, including sales by third-party sellers. Increased unit sales were driven largely by our continued efforts to reduce prices for our customers, including from our shipping offers, increased in-stock inventory availability, and increased selection.

International sales increased 9% in Q1 2019 compared to the comparable prior year period. The sales growth primarily reflects increased unit sales, including sales by third-party sellers. Increased unit sales were driven largely by our continued efforts to reduce prices for our customers, including from our shipping offers, increased in-stock inventory availability, and increased selection. Changes in foreign currency exchange rates impacted International net sales by \$(1.1) billion for Q1 2019.

AWS sales increased 41% in Q1 2019 compared to the comparable prior year period. The sales growth primarily reflects increased customer usage, partially offset by pricing changes. Pricing changes were driven largely by our continued efforts to reduce prices for our customers.

Operating Income (Loss)

Operating income (loss) by segment is as follows (in millions):

	Three Months Ended March 31,	
	2018	2019
Operating Income (Loss):		
North America	\$ 1,149	\$ 2,287
International	(622)	(90)
AWS	1,400	2,223
Consolidated	<u>\$ 1,927</u>	<u>\$ 4,420</u>

Operating income increased from \$1.9 billion in Q1 2018 to \$4.4 billion in Q1 2019. We believe that operating income is a more meaningful measure than gross profit and gross margin due to the diversity of our product categories and services.

The increase in North America operating income in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to increased unit sales, including sales by third-party sellers, advertising sales, and slower growth in certain operating expenses, partially offset by increased marketing expense.

The decrease in International operating loss in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to increased unit sales, including sales by third-party sellers, advertising sales, and slower growth in certain operating expenses, partially offset by increased marketing expense. Changes in foreign exchange rates impacted operating loss by \$(39) million for Q1 2019.

The increase in AWS operating income in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to increased customer usage and cost structure productivity, partially offset by pricing changes and increased spending on technology infrastructure and payroll and related expenses, which was primarily driven by additional investments to support the business growth. Changes in foreign exchange rates impacted operating income by \$110 million for Q1 2019.

Operating Expenses

Information about operating expenses is as follows (in millions):

	Three Months Ended March 31,	
	2018	2019
Operating Expenses:		
Cost of sales	\$ 30,735	\$ 33,920
Fulfillment	7,792	8,601
Marketing	2,699	3,664
Technology and content	6,759	7,927
General and administrative	1,067	1,173
Other operating expense (income), net	63	(5)
Total operating expenses	\$ 49,115	\$ 55,280
Year-over-year Percentage Growth:		
Cost of sales	37%	10 %
Fulfillment	66	10
Marketing	41	36
Technology and content	40	17
General and administrative	34	10
Other operating expense (income), net	44	(108)
Percent of Net Sales:		
Cost of sales	60.2%	56.8 %
Fulfillment	15.3	14.4
Marketing	5.3	6.1
Technology and content	13.2	13.3
General and administrative	2.1	2.0
Other operating expense (income), net	0.1	—

Cost of Sales

Cost of sales primarily consists of the purchase price of consumer products, digital media content costs where we record revenue gross, including video and music, packaging supplies, sortation and delivery centers and related equipment costs, and inbound and outbound shipping costs, including where we are the transportation service provider.

The increase in cost of sales in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to increased product and shipping costs resulting from increased sales.

Shipping costs to receive products from our suppliers are included in our inventory and recognized as cost of sales upon sale of products to our customers. Shipping costs, which include sortation and delivery centers and transportation costs, were \$6.1 billion and \$7.3 billion in Q1 2018 and Q1 2019. We expect our cost of shipping to continue to increase to the extent our customers accept and use our shipping offers at an increasing rate, we reduce shipping rates, we use more expensive shipping methods, which may include faster delivery, and we offer additional services. We seek to mitigate costs of shipping over time in part through achieving higher sales volumes, optimizing our fulfillment network, negotiating better terms with our suppliers, and achieving better operating efficiencies. We believe that offering low prices to our customers is fundamental to our future success, and one way we offer lower prices is through shipping offers.

Costs to operate our AWS segment are primarily classified as “Technology and content” as we leverage a shared infrastructure that supports both our internal technology requirements and external sales to AWS customers.

Fulfillment

Fulfillment costs primarily consist of those costs incurred in operating and staffing our North America and International fulfillment centers, customer service centers, and physical stores and payment processing costs. While AWS payment processing and related transaction costs are included in fulfillment, AWS costs are primarily classified as “Technology and content.” Fulfillment costs as a percentage of net sales may vary due to several factors, such as payment processing and related transaction

costs, our level of productivity and accuracy, changes in volume, size, and weight of units received and fulfilled, timing of fulfillment network and physical store expansion, the extent we utilize fulfillment services provided by third parties, mix of products and services sold, and our ability to affect customer service contacts per unit by implementing improvements in our operations and enhancements to our customer self-service features. Additionally, because payment processing and fulfillment costs associated with seller transactions are based on the gross purchase price of underlying transactions, and payment processing and related transaction and fulfillment costs are higher as a percentage of sales versus our retail sales, sales by our sellers have higher fulfillment costs as a percent of net sales.

The increase in fulfillment costs in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to costs from expanding our fulfillment network, which includes physical stores, and variable costs corresponding with increased product and service sales volume and inventory levels.

We seek to expand our fulfillment network to accommodate a greater selection and in-stock inventory levels and to meet anticipated shipment volumes from sales of our own products as well as sales by third parties for which we provide the fulfillment services. We regularly evaluate our facility requirements.

Marketing

We direct customers to our stores primarily through a number of targeted online marketing channels, such as our sponsored search, third party customer referrals, social and online advertising, television advertising, and other initiatives. Our marketing costs are largely variable, based on growth in sales and changes in rates. To the extent there is increased or decreased competition for these traffic sources, or to the extent our mix of these channels shifts, we would expect to see a corresponding change in our marketing costs.

The increase in marketing costs in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to increased spending on online marketing channels, as well as payroll and related expenses for personnel engaged in marketing and selling activities.

While costs associated with Amazon Prime memberships and other shipping offers are not included in marketing expense, we view these offers as effective worldwide marketing tools, and intend to continue offering them indefinitely.

Technology and Content

Technology and content costs include payroll and related expenses for employees involved in the research and development of new and existing products and services, development, design, and maintenance of our stores, curation and display of products and services made available in our online stores, and infrastructure costs. Infrastructure costs include servers, networking equipment, and data center related depreciation, rent, utilities, and other expenses necessary to support AWS and other Amazon businesses. Collectively, these costs reflect the investments we make in order to offer a wide variety of products and services to our customers.

We seek to invest efficiently in numerous areas of technology and content so we may continue to enhance the customer experience and improve our process efficiency through rapid technology developments, while operating at an ever increasing scale. Our technology and content investment and capital spending projects often support a variety of product and service offerings due to geographic expansion and the cross-functionality of our systems and operations. We expect spending in technology and content to increase over time as we continue to add employees and technology infrastructure. These costs are allocated to segments based on usage. The increase in technology and content costs in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to an increase in spending on technology infrastructure and increased payroll and related costs associated with technical teams responsible for expanding our existing products and services and initiatives to introduce new products and service offerings. See Item 7 of Part II, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Overview” of our 2018 Annual Report on Form 10-K for a discussion of how management views advances in technology and the importance of innovation.

General and Administrative

The increase in general and administrative costs in absolute dollars in Q1 2019, compared to the comparable prior year period, is primarily due to increases in payroll and related expenses.

Other Operating Expense (Income), Net

Other operating expense (income), net was \$63 million and \$(5) million for Q1 2018 and Q1 2019, and was primarily related to the amortization of intangible assets and in Q1 2019 was offset by a gain on the sale of a business.

Interest Income and Expense

Our interest income was \$80 million and \$183 million during Q1 2018 and Q1 2019. We generally invest our excess cash in AAA-rated money market funds and investment grade short- to intermediate-term fixed income securities. Our interest income corresponds with the average balance of invested funds based on the prevailing rates, which vary depending on the geographies and currencies in which they are invested.

Interest expense was \$330 million and \$366 million during Q1 2018 and Q1 2019, and was primarily related to long-term debt and finance leases.

Other Income (Expense), Net

Other income (expense), net was \$239 million and \$164 million during Q1 2018 and Q1 2019. The primary components of other income (expense), net are related to equity warrant valuation, equity securities gains, and foreign currency.

Income Taxes

Our tax provision or benefit from income taxes for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes, we make a cumulative adjustment.

Our quarterly tax provision, and our quarterly estimate of our annual effective tax rate, is subject to significant variation due to several factors, including variability in accurately predicting our pre-tax and taxable income and loss and the mix of jurisdictions to which they relate, intercompany transactions, the applicability of special tax regimes, changes in how we do business, acquisitions, investments, audit-related developments, changes in our stock price, changes in our deferred tax assets and liabilities and their valuation, foreign currency gains (losses), changes in statutes, regulations, case law, and administrative practices, principles, and interpretations related to tax, including changes to the global tax framework, competition, and other laws and accounting rules in various jurisdictions, and relative changes of expenses or losses for which tax benefits are not recognized. Additionally, our effective tax rate can be more or less volatile based on the amount of pre-tax income or loss. For example, the impact of discrete items and non-deductible expenses on our effective tax rate is greater when our pre-tax income is lower.

For 2019, we estimate that our effective tax rate will be favorably affected by the impact of excess tax benefits from stock-based compensation and the U.S. federal research and development credit and adversely affected by state income taxes and losses incurred in certain foreign jurisdictions for which we may not realize a tax benefit. Losses for which we may not realize a related tax benefit, primarily due to losses of foreign subsidiaries, reduce our pre-tax income without a corresponding reduction in our tax expense, and therefore increase our effective tax rate. We record valuation allowances against the deferred tax assets associated with losses for which we may not realize a related tax benefit.

Our income tax provisions for the three months ended March 31, 2018 and March 31, 2019 were \$287 million and \$836 million, which included \$368 million and \$261 million of net discrete tax benefits primarily attributable to excess tax benefits from stock-based compensation.

Non-GAAP Financial Measures

Regulation G, Conditions for Use of Non-GAAP Financial Measures, and other SEC regulations define and prescribe the conditions for use of certain non-GAAP financial information. Our measures of free cash flows and the effect of foreign exchange rates on our consolidated statements of operations meet the definition of non-GAAP financial measures.

We provide multiple measures of free cash flows because we believe these measures provide additional perspective on the impact of acquiring property and equipment with cash and through finance leases and financing obligations. We adopted new lease accounting guidance on January 1, 2019 without retrospectively adjusting prior periods. As a result, the line items used in our calculation of measures of free cash flows have changed. See Item 1 of Part I, “Financial Statements — Note 1 — Accounting Policies.”

Free Cash Flow

Free cash flow is cash flow from operations reduced by “Purchases of property and equipment, net of proceeds from property and equipment incentives.” The following is a reconciliation of free cash flow to the most comparable GAAP cash flow measure, “Net cash provided by (used in) operating activities,” for the trailing twelve months ended March 31, 2018 and 2019 (in millions):

	Twelve Months Ended March 31,	
	2018	2019
Net cash provided by (used in) operating activities	\$ 18,194	\$ 34,360
Purchases of property and equipment, net of proceeds from property and equipment incentives	(10,924)	(11,316)
Free cash flow	\$ 7,270	\$ 23,044
Net cash provided by (used in) investing activities	\$ (26,265)	\$ (19,959)
Net cash provided by (used in) financing activities	\$ 8,653	\$ (7,899)

Free Cash Flow Less Principal Repayments of Finance Leases and Financing Obligations

Free cash flow less principal repayments of finance leases and financing obligations is free cash flow reduced by “Principal repayments of finance leases” and “Principal repayments of financing obligations.” Principal repayments of finance leases and financing obligations approximates the actual payments of cash for our finance leases and financing obligations. The following is a reconciliation of free cash flow less principal repayments of finance leases and financing obligations to the most comparable GAAP cash flow measure, “Net cash provided by (used in) operating activities,” for the trailing twelve months ended March 31, 2018 and 2019 (in millions):

	Twelve Months Ended March 31,	
	2018	2019
Net cash provided by (used in) operating activities	\$ 18,194	\$ 34,360
Purchases of property and equipment, net of proceeds from property and equipment incentives	(10,924)	(11,316)
Free cash flow	7,270	23,044
Principal repayments of finance leases (1)	(5,981)	(7,649)
Principal repayments of financing obligations (1)	(235)	(266)
Free cash flow less principal repayments of finance leases and financing obligations	\$ 1,054	\$ 15,129
Net cash provided by (used in) investing activities	\$ (26,265)	\$ (19,959)
Net cash provided by (used in) financing activities	\$ 8,653	\$ (7,899)

(1) Amounts for 2018 have not been retrospectively adjusted.

Free Cash Flow Less Equipment Finance Leases and Principal Repayments of All Other Finance Leases and Financing Obligations

Free cash flow less equipment finance leases and principal repayments of all other finance leases and financing obligations is free cash flow reduced by equipment acquired under finance leases, which is included in “Property and equipment acquired under finance leases,” principal repayments of all other finance lease liabilities, which is included in “Principal repayments of finance leases,” and “Principal repayments of financing obligations.” All other finance lease liabilities and financing obligations consists of property. In this measure, equipment acquired under finance leases is reflected as if these assets had been purchased with cash, which is not the case as these assets have been leased. The following is a reconciliation of free cash flow less equipment finance leases and principal repayments of all other finance leases and financing obligations to the most comparable GAAP cash flow measure, “Net cash provided by (used in) operating activities,” for the trailing twelve months ended March 31, 2018 and 2019 (in millions):

	Twelve Months Ended March 31,	
	2018	2019
Net cash provided by (used in) operating activities	\$ 18,194	\$ 34,360
Purchases of property and equipment, net of proceeds from property and equipment incentives	(10,924)	(11,316)
Free cash flow	7,270	23,044
Equipment acquired under finance leases (1)	(10,020)	(10,909)
Principal repayments of all other finance leases (2)	—	(76)
Principal repayments of financing obligations	(235)	(266)
Free cash flow less equipment finance leases and principal repayments of all other finance leases and financing obligations	\$ (2,985)	\$ 11,793
Net cash provided by (used in) investing activities	\$ (26,265)	\$ (19,959)
Net cash provided by (used in) financing activities	\$ 8,653	\$ (7,899)

- (1) For the twelve months ended March 31, 2019, this amount relates to equipment included in “Property and equipment acquired under finance leases” of \$10,972 million. Amounts for 2018 have not been retrospectively adjusted.
- (2) For the twelve months ended March 31, 2019, this amount relates to property included in “Principal repayments of finance leases” of \$7,649 million. Amounts for 2018 have not been retrospectively adjusted.

All of these free cash flows measures have limitations as they omit certain components of the overall cash flow statement and do not represent the residual cash flow available for discretionary expenditures. For example, these measures of free cash flows do not incorporate the portion of payments representing principal reductions of debt or cash payments for business acquisitions. Additionally, our mix of property and equipment acquisitions with cash or other financing options may change over time. Therefore, we believe it is important to view free cash flows measures only as a complement to our entire consolidated statements of cash flows.

Effect of Foreign Exchange Rates

Information regarding the effect of foreign exchange rates, versus the U.S. Dollar, on our net sales, operating expenses, and operating income is provided to show reported period operating results had the foreign exchange rates remained the same as those in effect in the comparable prior year periods. The effect on our net sales, operating expenses, and operating income from changes in our foreign exchange rates versus the U.S. Dollar is as follows (in millions):

	Three Months Ended March 31,					
	2018			2019		
	As Reported	Exchange Rate Effect (1)	At Prior Year Rates (2)	As Reported	Exchange Rate Effect (1)	At Prior Year Rates (2)
Net sales	\$ 51,042	\$ (1,555)	\$ 49,487	\$ 59,700	\$ 1,127	\$ 60,827
Operating expenses	49,115	(1,584)	47,531	55,280	1,211	56,491
Operating income	1,927	29	1,956	4,420	(84)	4,336

- (1) Represents the change in reported amounts resulting from changes in foreign exchange rates from those in effect in the comparable prior year period for operating results.
- (2) Represents the outcome that would have resulted had foreign exchange rates in the reported period been the same as those in effect in the comparable prior year period for operating results.

Guidance

We provided guidance on April 25, 2019, in our earnings release furnished on Form 8-K as set forth below. These forward-looking statements reflect Amazon.com's expectations as of April 25, 2019, and are subject to substantial uncertainty. Our results are inherently unpredictable and may be materially affected by many factors, such as fluctuations in foreign exchange rates, changes in global economic conditions and customer spending, world events, the rate of growth of the Internet, online commerce, and cloud services, as well as those outlined in Item 1A of Part II, "Risk Factors."

Second Quarter 2019 Guidance

- Net sales are expected to be between \$59.5 billion and \$63.5 billion, or to grow between 13% and 20% compared with second quarter 2018. This guidance anticipates an unfavorable impact of approximately 150 basis points from foreign exchange rates.
- Operating income is expected to be between \$2.6 billion and \$3.6 billion, compared with \$3.0 billion in second quarter 2018.
- This guidance assumes, among other things, that no additional business acquisitions, investments, restructurings, or legal settlements are concluded.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk for the effect of interest rate changes, foreign currency fluctuations, and changes in the market values of our investments. Information relating to quantitative and qualitative disclosures about market risk is set forth below and in Item 2 of Part I, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources.”

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and our long-term debt. Our long-term debt is carried at amortized cost and fluctuations in interest rates do not impact our consolidated financial statements. However, the fair value of our debt, which pays interest at a fixed rate, will generally fluctuate with movements of interest rates, increasing in periods of declining rates of interest and declining in periods of increasing rates of interest. All of our cash equivalent and marketable fixed income securities are designated as available-for-sale and, accordingly, are presented at fair value on our consolidated balance sheets. We generally invest our excess cash in AAA-rated money market funds and investment grade short- to intermediate-term fixed income securities. Fixed income securities may have their fair market value adversely affected due to a rise in interest rates, and we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates.

Foreign Exchange Risk

During Q1 2019, net sales from our International segment accounted for 27% of our consolidated revenues. Net sales and related expenses generated from our internationally-focused stores, including within Canada and Mexico (which are included in our North America segment), are primarily denominated in the functional currencies of the corresponding stores and primarily include Euros, British Pounds, and Japanese Yen. The results of operations of, and certain of our intercompany balances associated with, our internationally-focused stores and AWS are exposed to foreign exchange rate fluctuations. Upon consolidation, as foreign exchange rates vary, net sales and other operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. For example, as a result of fluctuations in foreign exchange rates throughout the period compared to rates in effect the prior year, International segment net sales in Q1 2019 decreased by \$1.1 billion in comparison with Q1 2018.

We have foreign exchange risk related to foreign-denominated cash, cash equivalents, and marketable securities (“foreign funds”). Based on the balance of foreign funds as of March 31, 2019, of \$10.2 billion, an assumed 5%, 10%, and 20% adverse change to foreign exchange would result in fair value declines of \$510 million, \$1.0 billion, and \$2.0 billion. All cash equivalent and marketable fixed income securities are classified as “available-for-sale.” Fluctuations in fair value are recorded in “Accumulated other comprehensive loss,” a separate component of stockholders’ equity. Equity securities with readily determinable fair values are included in “Marketable securities” on our consolidated balance sheets and are measured at fair value with changes recognized in net income.

We have foreign exchange risk related to our intercompany balances denominated in various foreign currencies. Based on the intercompany balances as of March 31, 2019, an assumed 5%, 10%, and 20% adverse change to foreign exchange would result in losses of \$170 million, \$355 million, and \$800 million, recorded to “Other income (expense), net.”

See Item 2 of Part I, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Effect of Foreign Exchange Rates” for additional information on the effect on reported results of changes in foreign exchange rates.

Investment Risk

As of March 31, 2019, our recorded value in equity and equity warrant investments in public and private companies was \$2.1 billion. Our equity and equity warrant investments in publicly traded companies represent \$713 million of our investments as of March 31, 2019, and are recorded at fair value, which is subject to market price volatility. We perform a qualitative assessment for our equity investments in private companies to identify impairment. If this assessment indicates that an impairment exists, we estimate the fair value of the investment and, if the fair value is less than carrying value, we write down the investment to fair value. Our assessment includes a review of recent operating results and trends, recent sales/acquisitions of the investee securities, and other publicly available data. The current global economic climate provides additional uncertainty. Valuations of private companies are inherently more complex due to the lack of readily available market data. As such, we believe that market sensitivities are not practicable.

Item 4. Controls and Procedures

We carried out an evaluation required by the Securities Exchange Act of 1934 (the “1934 Act”), under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the 1934 Act, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the 1934 Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

During the most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Item 1 of Part I, “Financial Statements — Note 4 — Commitments and Contingencies — Legal Proceedings.”

Item 1A. Risk Factors

Please carefully consider the following risk factors. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected. In addition, the current global economic climate amplifies many of these risks.

We Face Intense Competition

Our businesses are rapidly evolving and intensely competitive, and we have many competitors in different industries, including physical, e-commerce, and omnichannel retail, e-commerce services, digital content and electronic devices, web and infrastructure computing services, and transportation and logistics services, and across geographies, including cross-border competition. Some of our current and potential competitors have greater resources, longer histories, more customers, and/or greater brand recognition, particularly with our newly-launched products and services and in our newer geographic regions. They may secure better terms from vendors, adopt more aggressive pricing, and devote more resources to technology, infrastructure, fulfillment, and marketing.

Competition may intensify, including with the development of new business models and the entry of new and well-funded competitors, and as our competitors enter into business combinations or alliances and established companies in other market segments expand to become competitive with our business. In addition, new and enhanced technologies, including search, web and infrastructure computing services, digital content, and electronic devices, may increase our competition. The Internet facilitates competitive entry and comparison shopping, and increased competition may reduce our sales and profits.

Our Expansion Places a Significant Strain on our Management, Operational, Financial, and Other Resources

We are rapidly and significantly expanding our global operations, including increasing our product and service offerings and scaling our infrastructure to support our retail and services businesses. This expansion increases the complexity of our business and places significant strain on our management, personnel, operations, systems, technical performance, financial resources, and internal financial control and reporting functions. We may not be able to manage growth effectively, which could damage our reputation, limit our growth, and negatively affect our operating results.

Our Expansion into New Products, Services, Technologies, and Geographic Regions Subjects Us to Additional Business, Legal, Financial, and Competitive Risks

We may have limited or no experience in our newer market segments, and our customers may not adopt our offerings. These offerings may present new and difficult technology challenges, and we may be subject to claims if customers of these offerings experience service disruptions or failures or other quality issues. In addition, profitability, if any, in our newer activities may be lower than in our older activities, and we may not be successful enough in these newer activities to recoup our investments in them. If any of this were to occur, it could damage our reputation, limit our growth, and negatively affect our operating results.

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

We may not be able to accurately forecast our growth rate. We base our expense levels and investment plans on sales estimates. A significant portion of our expenses and investments is fixed, and we may not be able to adjust our spending quickly enough if our sales are less than expected.

Our revenue growth may not be sustainable, and our percentage growth rates may decrease. Our revenue and operating profit growth depends on the continued growth of demand for the products and services offered by us or our sellers, and our business is affected by general economic and business conditions worldwide. A softening of demand, whether caused by changes in customer preferences or a weakening of the U.S. or global economies, may result in decreased revenue or growth.

Our sales and operating results will also fluctuate for many other reasons, including due to risks described elsewhere in this section and the following:

- our ability to retain and increase sales to existing customers, attract new customers, and satisfy our customers' demands;
- our ability to retain and expand our network of sellers;
- our ability to offer products on favorable terms, manage inventory, and fulfill orders;
- the introduction of competitive stores, websites, products, services, price decreases, or improvements;
- changes in usage or adoption rates of the Internet, e-commerce, electronic devices, and web services, including outside the U.S.;
- timing, effectiveness, and costs of expansion and upgrades of our systems and infrastructure;
- the success of our geographic, service, and product line expansions;
- the extent to which we finance, and the terms of any such financing for, our current operations and future growth;
- the outcomes of legal proceedings and claims, which may include significant monetary damages or injunctive relief and could have a material adverse impact on our operating results;
- variations in the mix of products and services we sell;
- variations in our level of merchandise and vendor returns;
- the extent to which we offer free shipping, continue to reduce prices worldwide, and provide additional benefits to our customers;
- factors affecting our reputation or brand image;
- the extent to which we invest in technology and content, fulfillment, and other expense categories;
- increases in the prices of fuel and gasoline, as well as increases in the prices of other energy products and commodities like paper and packing supplies;
- the extent to which our equity-method investees record significant operating and non-operating items;
- the extent to which operators of the networks between our customers and our stores successfully charge fees to grant our customers unimpaired and unconstrained access to our online services;
- our ability to collect amounts owed to us when they become due;
- the extent to which use of our services is affected by spyware, viruses, phishing and other spam emails, denial of service attacks, data theft, computer intrusions, outages, and similar events; and
- terrorist attacks and armed hostilities.

Our International Operations Expose Us to a Number of Risks

Our international activities are significant to our revenues and profits, and we plan to further expand internationally. In certain international market segments, we have relatively little operating experience and may not benefit from any first-to-market advantages or otherwise succeed. It is costly to establish, develop, and maintain international operations and stores, and promote our brand internationally. Our international operations may not be profitable on a sustained basis.

In addition to risks described elsewhere in this section, our international sales and operations are subject to a number of risks, including:

- local economic and political conditions;
- government regulation (such as regulation of our product and service offerings and of competition); restrictive governmental actions (such as trade protection measures, including export duties and quotas and custom duties and tariffs); nationalization; and restrictions on foreign ownership;
- restrictions on sales or distribution of certain products or services and uncertainty regarding liability for products, services, and content, including uncertainty as a result of less Internet-friendly legal systems, local laws, lack of legal precedent, and varying rules, regulations, and practices regarding the physical and digital distribution of media products and enforcement of intellectual property rights;
- business licensing or certification requirements, such as for imports, exports, web services, and electronic devices;
- limitations on the repatriation and investment of funds and foreign currency exchange restrictions;
- limited fulfillment and technology infrastructure;
- shorter payable and longer receivable cycles and the resultant negative impact on cash flow;

- laws and regulations regarding consumer and data protection, privacy, network security, encryption, payments, and restrictions on pricing or discounts;
- lower levels of use of the Internet;
- lower levels of consumer spending and fewer opportunities for growth compared to the U.S.;
- lower levels of credit card usage and increased payment risk;
- difficulty in staffing, developing, and managing foreign operations as a result of distance, language, and cultural differences;
- different employee/employer relationships and the existence of works councils and labor unions;
- compliance with the U.S. Foreign Corrupt Practices Act and other applicable U.S. and foreign laws prohibiting corrupt payments to government officials and other third parties;
- laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans, and taxes; and
- geopolitical events, including war and terrorism.

As international physical, e-commerce, and omnichannel retail and other services grow, competition will intensify, including through adoption of evolving business models. Local companies may have a substantial competitive advantage because of their greater understanding of, and focus on, the local customer, as well as their more established local brand names. We may not be able to hire, train, retain, and manage required personnel, which may limit our international growth.

The People's Republic of China ("PRC") and India regulate Amazon's and its affiliates' businesses and operations in country through regulations and license requirements that may restrict (i) foreign investment in and operation of the Internet, IT infrastructure, data centers, retail, delivery, and other sectors, (ii) Internet content, and (iii) the sale of media and other products and services. For example, in order to meet local ownership and regulatory licensing requirements, www.amazon.cn is operated by PRC companies that are indirectly owned, either wholly or partially, by PRC nationals. In addition, we provide certain technology services in China in conjunction with third parties that hold PRC licenses to provide services. In India, the government restricts the ownership or control of Indian companies by foreign entities involved in online multi-brand retail trading activities. For www.amazon.in, we provide certain marketing tools and logistics services to third-party sellers to enable them to sell online and deliver to customers, and we hold indirect minority interests in entities that are third-party sellers on the www.amazon.in marketplace. Although we believe these structures and activities comply with existing laws, they involve unique risks, and the PRC and India may from time to time consider and implement additional changes in their foreign investment rules that could impact these structures and activities. There are substantial uncertainties regarding the interpretation of PRC and Indian laws and regulations, and it is possible that these governments will ultimately take a view contrary to ours. In addition, our Chinese and Indian businesses and operations may be unable to continue to operate if we or our affiliates are unable to access sufficient funding or if China enforce contractual relationships with respect to management and control of such businesses. If our international activities were found to be in violation of any existing or future PRC, Indian or other laws or regulations or if interpretations of those laws and regulations were to change, our businesses in those countries could be subject to fines and other financial penalties, have licenses revoked, or be forced to restructure our operations or shut down entirely.

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

If we do not adequately predict customer demand or otherwise optimize and operate our fulfillment network and data centers successfully, it could result in excess or insufficient fulfillment or data center capacity, or result in increased costs, impairment charges, or both, or harm our business in other ways. As we continue to add fulfillment and data center capability or add new businesses with different requirements, our fulfillment and data center networks become increasingly complex and operating them becomes more challenging. There can be no assurance that we will be able to operate our networks effectively.

In addition, a failure to optimize inventory in our fulfillment network will increase our net shipping cost by requiring long-zone or partial shipments. We and our co-sourcers may be unable to adequately staff our fulfillment network and customer service centers. If the other businesses on whose behalf we perform inventory fulfillment services deliver product to our fulfillment centers in excess of forecasts, we may be unable to secure sufficient storage space and may be unable to optimize our fulfillment network.

We rely on a limited number of shipping companies to deliver inventory to us and completed orders to our customers. If we are not able to negotiate acceptable terms with these companies or they experience performance problems or other difficulties, it could negatively impact our operating results and customer experience. In addition, our ability to receive inbound inventory efficiently and ship completed orders to customers also may be negatively affected by inclement weather, fire, flood, power loss, earthquakes, labor disputes, acts of war or terrorism, acts of God, and similar factors.

Under some of our commercial agreements, we maintain the inventory of other companies, thereby increasing the complexity of tracking inventory and operating our fulfillment network. Our failure to properly handle such inventory or the inability of these other companies to accurately forecast product demand would result in unexpected costs and other harm to our business and reputation.

The Seasonality of Our Business Places Increased Strain on Our Operations

We expect a disproportionate amount of our net sales to occur during our fourth quarter. If we do not stock or restock popular products in sufficient amounts such that we fail to meet customer demand, it could significantly affect our revenue and our future growth. If we overstock products, we may be required to take significant inventory markdowns or write-offs and incur commitment costs, which could reduce profitability. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery for the holiday season. If too many customers access our websites within a short period of time due to increased demand, we may experience system interruptions that make our websites unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. In addition, we may be unable to adequately staff our fulfillment network and customer service centers during these peak periods and delivery and other fulfillment companies and customer service co-sourcers may be unable to meet the seasonal demand. We also face risks described elsewhere in this Item 1A relating to fulfillment network optimization and inventory.

We generally have payment terms with our retail vendors that extend beyond the amount of time necessary to collect proceeds from our consumer customers. As a result of holiday sales, as of December 31 of each year, our cash, cash equivalents, and marketable securities balances typically reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). This operating cycle results in a corresponding increase in accounts payable as of December 31. Our accounts payable balance generally declines during the first three months of the year, resulting in a corresponding decline in our cash, cash equivalents, and marketable securities balances.

Our Business Could Suffer if We Are Unsuccessful in Making, Integrating, and Maintaining Commercial Agreements, Strategic Alliances, and Other Business Relationships

We provide physical, e-commerce, and omnichannel retail and other services to businesses through commercial agreements, strategic alliances, and business relationships. Under these agreements, we provide web services, technology, fulfillment, computing, digital storage, and other services, as well as enable sellers to offer products or services through our stores. These arrangements are complex and require substantial infrastructure capacity, personnel, and other resource commitments, which may limit the amount of business we can service. We may not be able to implement, maintain, and develop the components of these commercial relationships, which may include web services, fulfillment, customer service, inventory management, tax collection, payment processing, hardware, content, and third-party software, and engaging third parties to perform services. The amount of compensation we receive under certain of our commercial agreements is partially dependent on the volume of the other company's sales. Therefore, if the other company's offerings are not successful, the compensation we receive may be lower than expected or the agreement may be terminated. Moreover, we may not be able to enter into additional commercial relationships and strategic alliances on favorable terms. We also may be subject to claims from businesses to which we provide these services if we are unsuccessful in implementing, maintaining, or developing these services.

As our agreements terminate, we may be unable to renew or replace these agreements on comparable terms, or at all. We may in the future enter into amendments on less favorable terms or encounter parties that have difficulty meeting their contractual obligations to us, which could adversely affect our operating results.

Our present and future e-commerce services agreements, other commercial agreements, and strategic alliances create additional risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- impairment of other relationships;
- variability in revenue and income from entering into, amending, or terminating such agreements or relationships; and
- difficulty integrating under the commercial agreements.

Our Business Could Suffer if We Are Unsuccessful in Making, Integrating, and Maintaining Acquisitions and Investments

We have acquired and invested in a number of companies, and we may acquire or invest in or enter into joint ventures with additional companies. These transactions (such as our acquisition of Whole Foods Market, Inc.) create risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;

- problems retaining key personnel;
- additional operating losses and expenses of the businesses we acquired or in which we invested;
- the potential impairment of tangible and intangible assets and goodwill, including as a result of acquisitions;
- the potential impairment of customer and other relationships of the company we acquired or in which we invested or our own customers as a result of any integration of operations;
- the difficulty of completing such transactions and achieving anticipated benefits within expected timeframes, or at all;
- the difficulty of incorporating acquired operations, technology, and rights into our offerings, and unanticipated expenses related to such integration;
- the difficulty of integrating a new company's accounting, financial reporting, management, information and information security, human resource, and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;
- for investments in which an investee's financial performance is incorporated into our financial results, either in full or in part, the dependence on the investee's accounting, financial reporting, and similar systems, controls, and processes;
- the difficulty of implementing at companies we acquire the controls, procedures, and policies appropriate for a larger public company;
- the risks associated with businesses we acquire or invest in, which may differ from or be more significant than the risks our other businesses face;
- potential unknown liabilities associated with a company we acquire or in which we invest; and
- for foreign transactions, additional risks related to the integration of operations across different cultures and languages, and the economic, political, and regulatory risks associated with specific countries.

As a result of future acquisitions or mergers, we might need to issue additional equity securities, spend our cash, or incur debt, contingent liabilities, or amortization expenses related to intangible assets, any of which could reduce our profitability and harm our business or only be available on unfavorable terms, if at all. In addition, valuations supporting our acquisitions and strategic investments could change rapidly given the current global economic climate. We could determine that such valuations have experienced impairments or other-than-temporary declines in fair value which could adversely impact our financial results.

We Have Foreign Exchange Risk

The results of operations of, and certain of our intercompany balances associated with, our international stores and product and service offerings are exposed to foreign exchange rate fluctuations. Upon translation, operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. As we have expanded our international operations, our exposure to exchange rate fluctuations has increased. We also hold cash equivalents and/or marketable securities in foreign currencies including British Pounds, Euros, and Japanese Yen. If the U.S. Dollar strengthens compared to these currencies, cash equivalents, and marketable securities balances, when translated, may be materially less than expected and vice versa.

The Loss of Key Senior Management Personnel or the Failure to Hire and Retain Highly Skilled and Other Key Personnel Could Negatively Affect Our Business

We depend on our senior management and other key personnel, particularly Jeffrey P. Bezos, our President, CEO, and Chairman. We do not have "key person" life insurance policies. We also rely on other highly skilled personnel. Competition for qualified personnel in the technology industry has historically been intense, particularly for software engineers, computer scientists, and other technical staff. The loss of any of our executive officers or other key employees or the inability to hire, train, retain, and manage qualified personnel, could harm our business.

We Could Be Harmed by Data Loss or Other Security Breaches

Because we process, store, and transmit large amounts of data, including personal information, failure to prevent or mitigate data loss or other security breaches, including breaches of our vendors' or customers' technology and systems, could expose us or our customers to a risk of loss or misuse of such information, adversely affect our operating results, result in litigation, regulatory action, and potential liability for us, deter customers or sellers from using our stores and services, and otherwise harm our business and reputation. We use third-party technology and systems for a variety of reasons, including,

without limitation, encryption and authentication technology, employee email, content delivery to customers, back-office support, and other functions. Some of our systems have experienced past security breaches, and, although they did not have a material adverse effect on our operating results, there can be no assurance of a similar result in the future. Although we have developed systems and processes that are designed to protect customer information and prevent data loss and other security breaches, including systems and processes designed to reduce the impact of a security breach at a third-party vendor or customer, such measures cannot provide absolute security.

We Face Risks Related to System Interruption and Lack of Redundancy

We experience occasional system interruptions and delays that make our websites and services unavailable or slow to respond and prevent us from efficiently fulfilling orders or providing services to third parties, which may reduce our net sales and the attractiveness of our products and services. If we are unable to continually add software and hardware, effectively upgrade our systems and network infrastructure, and take other steps to improve the efficiency of our systems, it could cause system interruptions or delays and adversely affect our operating results.

Our computer and communications systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins, and similar events or disruptions. Any of these events could cause system interruption, delays, and loss of critical data, and could prevent us from accepting and fulfilling customer orders and providing services, which could make our product and service offerings less attractive and subject us to liability. Our systems are not fully redundant and our disaster recovery planning may not be sufficient. In addition, we may have inadequate insurance coverage to compensate for any related losses. Any of these events could damage our reputation and be expensive to remedy.

We Face Significant Inventory Risk

In addition to risks described elsewhere in this Item 1A relating to fulfillment network and inventory optimization by us and third parties, we are exposed to significant inventory risks that may adversely affect our operating results as a result of seasonality, new product launches, rapid changes in product cycles and pricing, defective merchandise, changes in consumer demand and consumer spending patterns, changes in consumer tastes with respect to our products, spoilage, and other factors. We endeavor to accurately predict these trends and avoid overstocking or understocking products we manufacture and/or sell. Demand for products, however, can change significantly between the time inventory or components are ordered and the date of sale. In addition, when we begin selling or manufacturing a new product, it may be difficult to establish vendor relationships, determine appropriate product or component selection, and accurately forecast demand. The acquisition of certain types of inventory or components may require significant lead-time and prepayment and they may not be returnable. We carry a broad selection and significant inventory levels of certain products, such as consumer electronics, and we may be unable to sell products in sufficient quantities or during the relevant selling seasons. Any one of the inventory risk factors set forth above may adversely affect our operating results.

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

We regard our trademarks, service marks, copyrights, patents, trade dress, trade secrets, proprietary technology, and similar intellectual property as critical to our success, and we rely on trademark, copyright, and patent law, trade secret protection, and confidentiality and/or license agreements with our employees, customers, and others to protect our proprietary rights. Effective intellectual property protection may not be available in every country in which our products and services are made available. We also may not be able to acquire or maintain appropriate domain names in all countries in which we do business. Furthermore, regulations governing domain names may not protect our trademarks and similar proprietary rights. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon, or diminish the value of our trademarks and other proprietary rights.

We may not be able to discover or determine the extent of any unauthorized use of our proprietary rights. Third parties that license our proprietary rights also may take actions that diminish the value of our proprietary rights or reputation. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, the steps we take to protect our intellectual property may not adequately protect our rights or prevent third parties from infringing or misappropriating our proprietary rights. We also cannot be certain that others will not independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights.

Other parties also may claim that we infringe their proprietary rights. We have been subject to, and expect to continue to be subject to, claims and legal proceedings regarding alleged infringement by us of the intellectual property rights of third parties. Such claims, whether or not meritorious, may result in the expenditure of significant financial and managerial resources, injunctions against us, or the payment of damages, including to satisfy indemnification obligations. We may need to obtain licenses from third parties who allege that we have infringed their rights, but such licenses may not be available on terms

acceptable to us or at all. In addition, we may not be able to obtain or utilize on terms that are favorable to us, or at all, licenses or other rights with respect to intellectual property we do not own. These risks have been amplified by the increase in third parties whose sole or primary business is to assert such claims.

Our digital content offerings depend in part on effective digital rights management technology to control access to digital content. If the digital rights management technology that we use is compromised or otherwise malfunctions, we could be subject to claims, and content providers may be unwilling to include their content in our service.

We Have a Rapidly Evolving Business Model and Our Stock Price Is Highly Volatile

We have a rapidly evolving business model. The trading price of our common stock fluctuates significantly in response to, among other risks, the risks described elsewhere in this Item 1A, as well as:

- changes in interest rates;
- conditions or trends in the Internet and the industry segments we operate in;
- quarterly variations in operating results;
- fluctuations in the stock market in general and market prices for Internet-related companies in particular;
- changes in financial estimates by us or securities analysts and recommendations by securities analysts;
- changes in our capital structure, including issuance of additional debt or equity to the public;
- changes in the valuation methodology of, or performance by, other e-commerce or technology companies; and
- transactions in our common stock by major investors and certain analyst reports, news, and speculation.

Volatility in our stock price could adversely affect our business and financing opportunities and force us to increase our cash compensation to employees or grant larger stock awards than we have historically, which could hurt our operating results or reduce the percentage ownership of our existing stockholders, or both.

Government Regulation Is Evolving and Unfavorable Changes Could Harm Our Business

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet, physical, e-commerce, and omnichannel retail, electronic devices, and other services. Existing and future laws and regulations may impede our growth. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, transportation, mobile communications, electronic device certification, electronic waste, energy consumption, environmental regulation, electronic contracts and other communications, competition, consumer protection, employment, trade and protectionist measures, web services, the provision of online payment services, information reporting requirements, unencumbered Internet access to our services or access to our facilities, the design and operation of websites, health and sanitation standards, the characteristics, legality, and quality of products and services, product labeling, and the commercial operation of unmanned aircraft systems. It is not clear how existing laws governing issues such as property ownership, libel, data protection, and personal privacy apply to the Internet, e-commerce, digital content, web services, and artificial intelligence technologies and services. Jurisdictions may regulate consumer-to-consumer online businesses, including certain aspects of our seller programs. Unfavorable regulations, laws, and decisions interpreting or applying those laws and regulations could diminish the demand for, or availability of, our products and services and increase our cost of doing business.

We Could Be Subject to Additional Tax Liabilities and Collection Obligations

We are subject to a variety of taxes and tax collection obligations in the U.S. (federal and state) and numerous foreign jurisdictions. We may recognize additional tax expense and be subject to additional tax liabilities, including other liabilities for tax collection obligations due to changes in laws, regulations, administrative practices, principles, and interpretations related to tax, including changes to the global tax framework, competition, and other laws and accounting rules in various jurisdictions. Such changes could come about as a result of economic, political, and other conditions. An increasing number of jurisdictions are considering or have adopted laws or administrative practices that impose new tax measures, including revenue-based taxes, targeting online commerce and the remote selling of goods and services. These include new obligations to collect sales, consumption, value added, or other taxes on online marketplaces and remote sellers, or other requirements that may result in liability for third party obligations. For example, the European Union, certain member states, and other countries have proposed or enacted taxes on online advertising and marketplace service revenues. Our results of operations and cash flows could be adversely effected by additional taxes of this nature imposed on us or additional taxes or penalties resulting from the failure to comply with any collection obligations or failure to provide information about our customers, suppliers, and other third parties for tax reporting purposes to various government agencies. In some cases we also may not have sufficient notice to enable us to build systems and adopt processes to properly comply by the effective date.

Our tax expense and liabilities may also be affected by other factors, such as changes in our business operations, acquisitions, investments, entry into new businesses and geographies, intercompany transactions, the relative amount of our foreign earnings, losses incurred in jurisdictions for which we are not able to realize related tax benefits, the applicability of special tax regimes, changes in foreign currency exchange rates, changes in our stock price, and changes in our deferred tax assets and liabilities and their valuation. Significant judgment is required in evaluating and estimating our tax expense and liabilities. In the ordinary course of our business, there are many transactions and calculations for which the ultimate tax determination is uncertain. For example, the legislation known as the U.S. Tax Cuts and Jobs Act of 2017 (the “U.S. Tax Act”) requires complex computations to be performed that were not previously required by U.S. tax law, significant judgments to be made in interpretation of the provisions of the U.S. Tax Act, significant estimates in calculations, and the preparation and analysis of information not previously relevant or regularly produced. The U.S. Treasury Department, the IRS, and other standard-setting bodies will continue to interpret or issue guidance on how provisions of the U.S. Tax Act will be applied or otherwise administered. As future guidance is issued, we may make adjustments to amounts that we have previously recorded that may materially impact our financial statements in the period in which the adjustments are made.

We are also currently subject to tax controversies in various jurisdictions, and these jurisdictions may assess additional tax liabilities against us. Developments in an audit, investigation, or other tax controversy could have a material effect on our operating results or cash flows in the period or periods for which that development occurs, as well as for prior and subsequent periods. We regularly assess the likelihood of an adverse outcome resulting from these proceedings to determine the adequacy of our tax accruals. Although we believe our tax estimates are reasonable, the final outcome of audits, investigations, and any other tax controversies could be materially different from our historical tax accruals.

Our Supplier Relationships Subject Us to a Number of Risks

We have significant suppliers, including licensors, and in some cases, limited or single-sources of supply, that are important to our sourcing, services, manufacturing, and any related ongoing servicing of merchandise and content. We do not have long-term arrangements with most of our suppliers to guarantee availability of merchandise, content, components, or services, particular payment terms, or the extension of credit limits. If our current suppliers were to stop selling or licensing merchandise, content, components, or services to us on acceptable terms, or delay delivery, including as a result of one or more supplier bankruptcies due to poor economic conditions, as a result of natural disasters, or for other reasons, we may be unable to procure alternatives from other suppliers in a timely and efficient manner and on acceptable terms, or at all. In addition, if our suppliers or other vendors violate applicable laws, regulations, our code of standards and responsibilities, or implement practices regarded as unethical, unsafe, or hazardous to the environment, it could damage our reputation, limit our growth, and negatively affect our operating results.

We May Be Subject to Risks Related to Government Contracts and Related Procurement Regulations

Our contracts with U.S., as well as state, local, and foreign, government entities are subject to various procurement regulations and other requirements relating to their formation, administration, and performance. We may be subject to audits and investigations relating to our government contracts, and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contract, refunding or suspending of payments, forfeiture of profits, payment of fines, and suspension or debarment from future government business. In addition, such contracts may provide for termination by the government at any time, without cause.

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

Some of the products we sell or manufacture may expose us to product liability or food safety claims relating to personal injury or illness, death, or environmental or property damage, and may require product recalls or other actions. Certain third parties also sell products using our services and stores that may increase our exposure to product liability claims, such as if these sellers do not have sufficient protection from such claims. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all. In addition, some of our agreements with our vendors and sellers do not indemnify us from product liability.

We Are Subject to Payments-Related Risks

We accept payments using a variety of methods, including credit card, debit card, credit accounts (including promotional financing), gift cards, direct debit from a customer’s bank account, consumer invoicing, physical bank check, and payment upon delivery. For existing and future payment options we offer to our customers, we may become subject to additional regulations and compliance requirements (including obligations to implement enhanced authentication processes that could result in significant costs and reduce the ease of use of our payments products), as well as fraud. For certain payment methods,

including credit and debit cards, we pay interchange and other fees, which may increase over time and raise our operating costs and lower profitability. We rely on third parties to provide certain Amazon-branded payment methods and payment processing services, including the processing of credit cards, debit cards, electronic checks, and promotional financing. In each case, it could disrupt our business if these companies become unwilling or unable to provide these services to us. We also offer co-branded credit card programs, which could adversely affect our operating results if terminated. We are also subject to payment card association operating rules, including data security rules, certification requirements, and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, or if our data security systems are breached, compromised, or otherwise unable to detect or prevent fraudulent activity, we may be liable for card issuing banks' costs, subject to fines and higher transaction fees, and lose our ability to accept credit and debit card payments from our customers, process electronic funds transfers, or facilitate other types of online payments, and our business and operating results could be adversely affected.

In addition, we provide regulated services in certain jurisdictions because we enable customers to keep account balances with us and transfer money to third parties, and because we provide services to third parties to facilitate payments on their behalf. In these jurisdictions, we may be subject to requirements for licensing, regulatory inspection, bonding and capital maintenance, the use, handling, and segregation of transferred funds, consumer disclosures, maintaining or processing data, and authentication. We are also subject to or voluntarily comply with a number of other laws and regulations relating to payments, money laundering, international money transfers, privacy and information security, and electronic fund transfers. If we were found to be in violation of applicable laws or regulations, we could be subject to additional requirements and civil and criminal penalties, or forced to cease providing certain services.

We Could Be Liable for Fraudulent or Unlawful Activities of Sellers

The law relating to the liability of online service providers is currently unsettled. In addition, governmental agencies could require changes in the way this business is conducted. Under our seller programs, we may be unable to prevent sellers from collecting payments, fraudulently or otherwise, when buyers never receive the products they ordered or when the products received are materially different from the sellers' descriptions. We also may be unable to prevent sellers in our stores or through other stores from selling unlawful, counterfeit, pirated, or stolen goods, selling goods in an unlawful or unethical manner, violating the proprietary rights of others, or otherwise violating our policies. Under our A2Z Guarantee, we reimburse buyers for payments up to certain limits in these situations, and as our third-party seller sales grow, the cost of this program will increase and could negatively affect our operating results. In addition, to the extent any of this occurs, it could harm our business or damage our reputation and we could face civil or criminal liability for unlawful activities by our sellers.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Disclosure Pursuant to Section 13(r) of the Exchange Act

We determined that, between January 2012 and March 2019, we processed and delivered orders of consumer products for certain individuals and entities located outside Iran covered by the Iran Threat Reduction and Syria Human Rights Act (“ITRA”), in addition to those we have previously disclosed, as follows: consumer products valued at approximately \$3,900 for individuals who may have been acting for nine Iranian embassies and diplomatic organizations located in countries other than Iran; consumer products valued at approximately \$1,700 for two entities owned or controlled by the Iranian government; consumer products valued at \$20 for an individual who may have been acting for an entity owned or controlled by the Iranian government; and consumer products valued at approximately \$8,500 for individuals who may have been acting for four entities designated under Executive Order 13224 or Executive Order 13382, three of which are owned or controlled by the Iranian government. The consumer products included books, other media, apparel, home and kitchen, jewelry, office, toys, health and beauty, consumer electronics, lawn and patio, automotive, software, grocery, and pet products. We are unable to accurately calculate the net profit attributable to these transactions. We do not plan to continue selling to these accounts in the future. Our review is ongoing and we are enhancing our processes designed to identify transactions associated with individuals and entities covered by the ITRA.

Item 6. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
3.1	Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the Quarter ended March 31, 2000).
3.2	Amended and Restated Bylaws of the Company (incorporated by reference to the Company's Current Report on Form 8-K, filed February 25, 2016).
31.1	Certification of Jeffrey P. Bezos, Chairman and Chief Executive Officer of Amazon.com, Inc., pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of Brian T. Olsavsky, Senior Vice President and Chief Financial Officer of Amazon.com, Inc., pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
32.1	Certification of Jeffrey P. Bezos, Chairman and Chief Executive Officer of Amazon.com, Inc., pursuant to 18 U.S.C. Section 1350.
32.2	Certification of Brian T. Olsavsky, Senior Vice President and Chief Financial Officer of Amazon.com, Inc., pursuant to 18 U.S.C. Section 1350.
101	The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, formatted in XBRL: (i) Consolidated Statements of Cash Flows, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Balance Sheets, and (v) Notes to Consolidated Financial Statements, tagged as blocks of text and including detailed tags.

SIGNATURES

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

AMAZON.COM, INC. (REGISTRANT)

By: /s/ Shelley L. Reynolds

Shelley L. Reynolds

**Vice President, Worldwide Controller
(Principal Accounting Officer)**

Dated: April 25, 2019