CASE STUDY REPORT

Meticulous Formatting of Case Study Document

Amazon.com, Inc. Case Study

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`![MetroCare Health Logo](https://www.metrocarehealth.org/wp-content/uploads/2021/10/MetroCare-Logo.png)`

Company Background

Amazon.com, Inc.

Christopher Noe and Joseph Weber

On May 15, 2017, Amazon.com celebrated the 20th anniversary of its initial public offering (IPO). Over the preceding two decades, Amazon had grown from a small e-commerce startup to the fourth largest U.S. public company, trailing only Apple, Alphabet (Google's parent), and Microsoft. The company reached such a size; however, with little to show in terms of profitability. Amazon chose to invest in expansion and research and development with the idea that sacrificing profit in the short term would allow the company to maximize profit in the long term.

Amazon was founded by Jeff Bezos. Prior to starting Amazon, Bezos worked in New York as a vice president at D. E. Shaw & Co., a global investment management firm, but decided to quit his job and move to Seattle to take advantage of the incredible growth of the Internet. The Amazon website launched on July 16, 1995.

Amazon began as an online bookstore, but the company had innovative strategies that set it apart from competitors. It offered discounts up to 30%, allowed customers to post their own book reviews on its website, and continually worked to improve the ease of placing orders with technological features like "1-Click" shopping. These strategies derived from Amazon's customer-focused mission statement:

> “Our vision is to be the Earth’s most customer-centric company; to build a place where people can come to find and discover anything they might want to buy online.”

On May 15, 1997, Amazon’s IPO, priced at $18 a share, raised $54 million. By day’s end, the company’s stock closed up 30% at $23.50, giving it a market capitalization of $438 million. The stock price (split-adjusted) increased by 7,000% over the next few years but lost 95% from its peak value during the 2000-01 dot-com crash. Throughout this tumultuous period, Amazon steadily branched out beyond books by adding other product categories to its website, including CDs, DVDs, consumer electronics, video games, software, and office products.

Amazon’s expansion was also aided by acquisitions. For example, the 2008 purchase of Audible, the audiobook seller, helped the company broaden its digital media offerings; the 2009 acquisition of Zappos.com helped the company increase its share in the market for shoes, clothing, and accessories; and the 2010 purchase of Quidsi, owner of diapers.com and soap.com, moved the company further into the market for consumer goods.

In 2005, Amazon introduced its Prime membership program as a means to increase customer loyalty. The program started out as a free two-day shipping service for an annual fee but later expanded to include free access to streaming movies, TV shows, music, and audiobooks; free unlimited photo storage; free e-book rentals; and early access to special shopping deals. In July 2015, Amazon introduced an online shopping holiday called Prime Day, where the company offered discounts only to Prime members. Amazon reported that the third annual Prime Day in 2017 was the biggest day in its history with sales surpassing 2016 Black Friday and Cyber Monday. Moreover, the number of new members joining on 2017 Prime Day pushed Prime membership to nearly 50% of all U.S. households.

Building off its beginnings as a purveyor of books, Amazon introduced the Kindle e-reader in 2007. It was the first device developed by the company, and it fundamentally changed the way people read books, newspapers, and magazines. Amazon followed the Kindle with other in-house developed devices — for example, Fire tablets, Fire TV streaming media players, and Echo smart speakers with the voice assistant Alexa.

In 2006, Amazon decided to rent out excess space on its computer network to other companies. That decision essentially represented the genesis of the cloud infrastructure as a service (IaaS) industry. As of 2016, worldwide total IaaS industry sales had grown to $25 billion and were expected to grow to $63 billion over the next five years. Amazon’s al a carte services, known as Amazon Web Services (AWS), initially appealed to Internet startups attracted by flexibility and cost savings. Over time, however, more established companies such as Juniper Networks, Intuit, and Netflix decided to unplug their private data servers and run their businesses entirely on Amazon’s IT backbone.

Not all of Amazon’s actions have proven successful. In 2014, for example, the company introduced the Fire Phone, but the device was a major flop and was discontinued the following year. Other examples of Amazon failures include Amazon Destinations, a hotel booking site; WebPay, a peer-to-peer payment service; Amazon Auctions, an auction website; and a line of premium diapers. None of these botched efforts fazed Bezos, however, who ingrained a tolerance for failure into Amazon's culture because of his belief that failed experiments are a necessary evil to create successful inventions.

Financial Performance

Exhibit 1 shows Amazon's stock price during its first 20 years, a period over which the company's shareholders earned a nearly 64,000% return. Amazon reached the 20th anniversary of its IPO with a market capitalization of $458 billion. This exhibit also shows Amazon's net income and cash flow from operations between 1997 and 2016. Cumulative net income over this period totaled only $4.9 billion with 60% coming from just 2015-16. Exhibit 2 provides Amazon's 2014-16 financial statements. Exhibit 3 provides descriptions of expense line items on the income statement. Exhibit 4 provides 2014-16 segment information for Amazon's retail and AWS businesses.

Focus on Long-Term Cash Flow Growth

Amazon's two decades of meager profitability originated from a strategic choice made in the company's early days to focus on the long-term. In 1997, Bezos articulated Amazon's philosophy in his first letter to shareholders:

> "We believe that a fundamental measure of our success will be the shareholder value we create over the long term. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital…We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions."

And, 20 years later, Amazon continued to emphasize a long-term focus:

> "Our financial focus is on long-term, sustainable growth in free cash flows. Free cash flows are driven primarily by increasing operating income and efficiently managing working capital and cash capital expenditures, including our decision to purchase or lease property and equipment. Increases in operating income primarily result from increases in sales of products and services and efficiently managing our operating costs, partially offset by investments we make in longer-term strategic initiatives. To increase sales of products and services, we focus on improving all aspects of the customer experience, including lowering prices, improving availability, offering faster delivery and performance times, increasing selection, increasing product categories and service offerings, expanding product information, improving ease of use, improving reliability, and earning customer trust."

Exhibit 5 provides Amazon's voluntary disclosure of non-GAAP financial information about free cash flows.

Despite Amazon consistently downplaying the significance of short-term accounting profitability, some market observers were of the opinion that the company's GAAP earnings were poised for considerable growth as the 20th anniversary of its IPO neared. For example, Barron's commented, "Ironically, now that Amazon has convinced the investing public of the unimportance of profits, its earnings are on the verge of soaring. Within five years, they could total $20 billion a year, a level only six U.S. companies are expected to reach this year. True enough, those forecasts have a way of coming down over time, but unless Amazon's next venture is launching a small nation-state, it will have a hard time investing away such a sum, not to mention its free cash flow, which is much higher."

Exhibits

Exhibit 1: Amazon.com, Inc. Stock Price, Cash Flow from Operations, and Net Income

Source: YCharts.

Exhibit 2: Amazon.com, Inc. Cash Flow Statements ($ Millions)

Year Ended December 31,

Year	2016	2015	2014
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	15,890	14,557	8,658
OPERATING ACTIVITIES:			
Net income (loss)	2,371	596	(241)
Adjustments to reconcile net income (loss) to net cash from operating activities:			
- Depreciation of property and equipment, including internal-use software and website development, and other amortization, including capitalized content costs	8,116	6,281	4,746
- Stock-based compensation	2,975	2,119	1,497
- Other operating expense, net	160	155	129
- Other expense (income), net	(20)	250	59
- Deferred income taxes	(246)	81	(316)
- Excess tax benefits from stock-based compensation	(829)	(119)	(6)
Changes in operating assets and liabilities:			
- Inventories	(1,426)	(2,187)	(1,193)

- Accounts receivable, net and other	(3,367)	(1,755)	(1,039)
- Accounts payable	5,030	4,294	1,759
- Accrued expenses and other	1,724	913	706
- Additions to unearned revenue	11,931	7,401	4,433
- Amortization of previously unearned revenue	(9,976)	(6,109)	(3,692)
Net cash provided by (used in) operating activities	16,443	11,920	6,842
INVESTING ACTIVITIES:			
- Purchases of property and equipment, including internal-use software and website development, net	(6,737)	(4,589)	(4,893)
- Acquisitions, net of cash acquired, and other	(116)	(795)	(979)
- Sales and maturities of marketable securities	4,733	3,025	3,349
- Purchases of marketable securities	(7,756)	(4,091)	(2,542)
Net cash provided by (used in) investing activities	(9,876)	(6,450)	(5,065)
FINANCING ACTIVITIES:			
- Excess tax benefits from stock-based compensation	829	119	6
- Proceeds from issuance of long-term debt	621	353	6,359
- Repayments of long-term debt and other	(354)	(1,652)	(513)
- Principal repayments of capital lease obligations	(3,860)	(2,462)	(1,285)
- Principal repayments of finance lease obligations	(147)	(121)	(135)
Net cash provided by (used in) financing activities	(2,911)	(3,763)	4,432
Foreign currency effect on cash and cash equivalents	(212)	(374)	(310)
Net increase (decrease) in cash and cash equivalents	3,444	1,333	5,899
CASH AND CASH EQUIVALENTS, END OF PERIOD	19,334	15,890	14,557

*AMAZON.COM, INC.

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Exhibit 2 (cont.) Amazon.com, Inc. Income Statements ($ Millions)

Year Ended December 31,

Year	2016	2015	2014
Net product sales	94,665	79,268	70,080
Net service sales	41,322	27,738	18,908
Total net sales	135,987	107,006	88,988
Operating expenses:			
- Cost of sales	88,265	71,651	62,752
- Fulfillment	17,619	13,410	10,766
- Marketing	7,233	5,254	4,332
- Technology and content	16,085	12,540	9,275
- General and administrative	2,432	1,747	1,552
- Other operating expense, net	167	171	133
Total operating expenses	131,801	104,773	88,810
Operating income	4,186	2,233	178
Interest income	100	50	39
Interest expense	(484)	(459)	(210)
Other income (expense), net	90	(256)	(118)
Total non-operating income (expense)	(294)	(665)	(289)
Income (loss) before income taxes	3,892	1,568	(111)
Provision for income taxes	(1,425)	(950)	(167)
Equity-method investment activity, net of tax	(96)	(22)	37
Net income (loss)	2,371	596	(241)

Exhibit 2 (cont.) Amazon.com, Inc. Balance Sheets ($ Millions)

December 31,

Year	2016	2015	2014
Current assets:			
Cash and cash equivalents	19,334	15,890	14,557
Marketable securities	6,647	3,918	2,859
Inventories	11,461	10,243	8,299
Accounts receivable, net and other	8,339	5,654	5,612
Total current assets	45,781	35,705	31,327
Property and equipment, net	29,114	21,838	16,967
Goodwill	3,784	3,759	3,319
Other assets	4,723	3,445	2,892
Total assets	83,402	64,747	54,505
Current liabilities:			
Accounts payable	25,309	20,397	15,459
Accrued expenses and other	13,739	10,372	9,807
Unearned revenue	4,768	3,118	1,823
Total current liabilities	43,816	33,887	28,089
Long-term debt	7,694	8,227	8,265
Other long-term liabilities	12,607	9,249	7,410
Stockholders’ equity:			
Common stock	5	5	5
Treasury stock, at cost	(1,837)	(1,837)	(1,837)
Additional paid-in capital	17,186	13,394	11,135
Accumulated other comprehensive loss	(985)	(723)	(511)
Retained earnings	4,916	2,545	1,949
Total stockholders’ equity	19,285	13,384	10,741

| Total liabilities and stockholders' equity | 83,402 | 64,747 | 54,505 |

Source: Amazon.com, Inc. 10-Ks, December 31, 2015-16.

Exhibit 3 Amazon.com, Inc. Expense Line Item Descriptions

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 Prime Video and Prime 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. 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. Payment processing and related transaction costs, including those associated with seller transactions, are classified in "Fulfillment" on our consolidated statements of operations.

Vendor Agreements

We have agreements with our vendors to receive funds for advertising services, cooperative marketing efforts, promotions, and volume rebates. We generally consider amounts received from vendors to be a reduction of the prices we pay for their goods, including property and equipment, or services, and therefore record those amounts as a reduction of the cost of inventory, cost of services, or cost of property and equipment. Vendor rebates are typically dependent upon reaching minimum purchase thresholds. We evaluate the likelihood of reaching purchase thresholds using past experience and current year forecasts. When volume rebates can be reasonably estimated, we record a portion of the rebate as we make progress towards the purchase threshold. When we receive direct reimbursements for costs incurred by us in advertising the vendor's product or service, the amount we receive is recorded as an offset to "Marketing" on our consolidated statements of operations.

Fulfillment

Fulfillment costs primarily consist of those costs incurred in operating and staffing our North America and International segments' fulfillment and customer service centers, including costs attributable to buying, receiving, inspecting, and warehousing inventories; picking, packaging, and preparing customer orders for shipment; payment processing and related transaction costs, including costs associated with our guarantee for certain seller transactions; responding to inquiries from customers; and supply chain management for our manufactured electronic devices. Fulfillment costs also include amounts paid to third parties that assist us in fulfillment and customer service operations.

Marketing

Marketing costs primarily consist of targeted online advertising, television advertising, public relations expenditures, and payroll and related expenses for personnel engaged in marketing and selling activities. We pay commissions to participants in our Associates program when their customer referrals result in product sales and classify such costs as "Marketing" on our consolidated statements of operations. We also participate in cooperative advertising arrangements with certain of our vendors and other third parties. Advertising and other promotional costs are expensed as incurred and were $3.3 billion, $3.8 billion, and $5.0 billion in 2014, 2015, and 2016. Prepaid advertising costs were not significant as of December 31, 2015, and 2016.

Technology and Content

Technology costs consist principally of research and development activities including payroll and related expenses for employees involved in application, production, maintenance, operation, and development of new and existing products and services, as well as AWS and other technology infrastructure costs. Content costs consist principally of payroll and related expenses for employees involved in category expansion, editorial content, buying, and merchandising selection. Technology and content costs are expensed as incurred, except for certain costs relating to the development of internal-use software and website development, including software used to upgrade and enhance our websites and applications supporting our business, which are capitalized and amortized over two years.

General and Administrative

General and administrative expenses primarily consist of payroll and related expenses; facilities and equipment, such as depreciation expense and rent; professional fees and litigation costs; and other general corporate costs for corporate functions, including accounting, finance, tax, legal, and human resources, among others.

Other Operating Expense, Net

Other operating expense, net, consists primarily of marketing-related, contract-based, and customer-related intangible asset amortization expense, and expenses related to legal settlements.

Source: Amazon.com, Inc. 10-K, December 31, 2016.

Exhibit 4 Amazon.com, Inc. Segment Information ($ Millions)

Year Ended December 31,

Year	2016	2015	2014
Net sales			
Retail	123,768	99,126	84,344
AWS	12,219	7,880	4,644

Total	135,987	107,006	88,988

Year Ended December 31,

Year	2016	2015	2014
Operating income			
Retail	1,078	726	(280)
AWS	3,108	1,507	458
Total	4,186	2,233	178

Source: Amazon.com, Inc. 10-K, December 31, 2016.

Exhibit 5 Amazon.com, Inc. Non-GAAP Financial Measures ($ Millions)

Free Cash Flow

Free cash flow is cash flow from operations reduced by "Purchases of property and equipment, including internal-use software and website development, net," which is included in cash flow from investing activities. 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 2014, 2015, and 2016 (in millions):

Year Ended December 31,

Year	2016	2015	2014
Net cash provided by (used in) operating activities	16,443	11,920	6,842
Purchases of property and equipment, including internal-use software and website development, net	(6,737)	(4,589)	(4,893)
Free cash flow	9,706	7,331	1,949

Free Cash Flow Less Lease Principal Repayments

Free cash flow less lease principal repayments is free cash flow reduced by "Principal repayments of capital lease obligations," and "Principal repayments of finance lease obligations," which are included in cash flow from financing activities. Free cash flow less lease principal repayments approximates the actual payments of cash for our capital and finance leases. The following is a reconciliation of free cash flow less lease principal repayments to the most comparable GAAP cash flow measure, “Net cash provided by (used in) operating activities,” for 2014, 2015, and 2016 (in millions):

Year Ended December 31,

Year	2016	2015	2014
Net cash provided by (used in) operating activities	16,443	11,920	6,842
Purchases of property and equipment, including internal-use software and website development, net	(6,737)	(4,589)	(4,893)
Principal repayments of capital lease obligations	(3,860)	(2,462)	(1,285)
Principal repayments of finance lease obligations	(147)	(121)	(135)
Free cash flow less lease principal repayments	5,699	4,748	529

Free Cash Flow Less Finance Lease Principal Repayments and Assets Acquired Under Capital Leases

Free cash flow less finance lease principal repayments and assets acquired under capital leases is free cash flow reduced by “Principal repayments of finance lease obligations,” which are included in cash flow from financing activities, and property and equipment acquired under capital leases. In this measure, property and equipment acquired under capital 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 finance lease principal repayments and assets acquired under capital leases to the most comparable GAAP cash flow measure, “Net cash provided by (used in) operating activities,” for 2014, 2015, and 2016 (in millions):

Year Ended December 31,

Year	2016	2015	2014
Net cash provided by (used in) operating activities	16,443	11,920	6,842
Purchases of property and equipment, including internal-use software and website development, net	(6,737)	(4,589)	(4,893)
Property and equipment acquired under capital leases	(5,704)	(4,717)	(4,008)
Principal repayments of finance lease obligations	(147)	(121)	(135)
Free cash flow less finance lease principal repayments and assets acquired under capital leases	3,855	2,493	(2,194)

Source: Amazon.com, Inc. 10-K, December 31, 2016.

Inc.