Amazon.com, Inc. (NASDAQ:AMZN) Q2 2015 Earnings Call July 23, 2015 5:00 PM ET

Executives

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Justin Post - Merrill Lynch, Pierce, Fenner & Smith, Inc.

Mark S. Mahaney - RBC Capital Markets LLC

Brian Nowak - Morgan Stanley & Co. LLC

Douglas T. Anmuth - JPMorgan Securities LLC

Carlos Kirjner-Neto - Sanford C. Bernstein & Co. LLC

Heath P. Terry - Goldman Sachs & Co.

Youssef H. Squali - Cantor Fitzgerald Securities

Ron V. Josey - JMP Securities LLC

Paul Vogel - Barclays Capital, Inc.

Eugene C. Munster - Piper Jaffray & Co (Broker)

Brian J. Pitz - Jefferies LLC

Colin A. Sebastian - Robert W. Baird & Co., Inc. (Broker)

Ross Sandler - Deutsche Bank Securities, Inc.

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Steve D. Ju - Credit Suisse Securities (NYSE:USA) LLC (Broker)

John R Blackledge - Cowen & Co. LLC

Scott Tilghman - B. Riley & Co. LLC

Operator

Greetings, thank you for standing by. Good day, everyone, and welcome to the Amazon.com Q2 2015 Financial Results Teleconference. At this time all participants are in a listen-only mode. After the presentation we will conduct a question-and-answer session. Today's call is being recorded.

For opening remarks I will be turning the call over to Director of Investor Relations, Phil Hardin. Please go ahead.

Phil Hardin - Director, Investor Relations

Hello. And welcome to our Q2 2015 financial results conference call. Joining us today is Brian Olsavsky, our CFO who will be available for questions after our prepared remarks. The following discussion and responses to your questions reflect management's views as of today, July 23, 2015 only and will include forward-looking statements. Actual results may differ materially. Additional information about factors that could potentially impact our financial results is included in today's press release and our filings with the SEC including our most recent annual report on Form 10-K.

As you listen to today's conference call we encourage you to have our press release in front of you which includes our financial results as well as metrics and commentary on the quarter. During this call we will discuss certain non-GAAP financial measures. In our press release slides accompanying this webcast and our filings with the SEC, each of which is posted on our IR website, you will find additional disclosures regarding these non-GAAP measures, including reconciliations of these measures with comparable GAAP measures. Finally unless otherwise stated, all comparisons in this call will be against our results for the comparable period of 2014.

Now I'll turn the call over to Brian.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Thanks, Phil. I will begin comments on our second-quarter financial results. Trailing 12-month operating cash flow increased 69% to $8.98 billion. Trailing 12-month free cash flow increased to $4.37 billion up from $1.04 billion. In the supplemental financial information and business metrics portion of our earnings release, we include a few additional free cash flow measures. We believe these measures provide additional perspective on the impact of acquiring property and equipment with cash and through capital and finance releases.

Trailing 12-month capital expenditures were $4.61 billion. Capital expenditures do not include the impact of property and equipment acquired under capital and finance lease obligations. The increase in capital expenditures and capital leases reflects additional investments in support of continued business growth due to investments in technology infrastructure, the majority of which is to support AWS and additional capacity to support our fulfillment operations.

Return on invested capital was 17% up from 6%. ROIC is trailing 12 month free cash flow divided by average total assets minus current liabilities excluding the current portion of long-term debt over five quarter-ends. Combination of common stock and stock-based awards outstanding was 488 million shares compared with 480 million one year ago. Worldwide revenue grew 20% to $23.18 billion, or 27% excluding the $1.39 billion unfavorable impact from year-over-year changes in foreign-exchange.

Worldwide paid unit growth was 22%. Worldwide active customer accounts was approximately 285 million. Excluding customers who only had three orders in the preceding 12 month period worldwide active customers were approximately 265 million up from approximately 237 million in the comparable prior year period. Worldwide seller units represented 45% of paid units, up from 41% in the comparable prior year period.

Now I will discuss operating expenses excluding stock-based compensation. Cost of sales was $15.16 billion or 65.4% of revenue compared with 69.3%. Fulfillment, marketing, technology and content and G&A combined was $6.95 billion or 29.9% of sales, up approximately 130 basis points year-over-year.

Fulfillment was $2.74 billion or 11.8% of revenue compared with 11.8%. Tech and content was $2.70 billion or 11.7% of revenue compared with 10.4%. Marketing was $1.1 billion or 4.7% of revenue compared with 4.7%.

Now I'll talk about our segment results. As a reminder, in the first quarter we changed our reportable segments to report North America, International, and Amazon Web Services. Consistent with prior periods we do not allocate two segments, our stock-based compensation, or the other operating expense line item.

In the North America segment, revenue grew 26% to $13.8 billion. Media revenue grew 6% to $2.62 billion or 7% excluding foreign-exchange. EGM revenue grew 31% to $10.99 billion or 32% excluding foreign-exchange. EGM now represents 80% of North America revenues. North America segment operating income increased 113% to $703 million a 5.1% operating margin. Excluding the $9 million favorable impact from foreign-exchange, North America segment operating income increased 111%.

In the International segment revenue increased 3% to $7.56 billion. Excluding the $1.37 billion year-over-year unfavorable impact from foreign-exchange, revenue growth was 22%. Media revenue decreased 12% to $2.09 billion or increased 3% excluding foreign-exchange. EGM revenue grew 10% to $5.43 billion or 31% excluding foreign-exchange. EGM now represents 72% of International revenues. International segment operating loss was $19 million compared to a loss of $2 million in the prior year period. International segment operating loss includes $89 million of unfavorable impact from foreign-exchange.

In the Amazon Web Services segment revenue increased 81% to $1.82 billion. Amazon Web Services segment operating income increased 407% to $391 million, a 21.4% operating margin. Excluding the $71 million favorable impact from foreign-exchange, AWS segment operating income increased 314%. Consolidated segment operating income increased 166% to $1.07 billion or 4.6% of revenue, up approximately 250 basis points year-over-year. Excluding the $9 million unfavorable impact from foreign-exchange, CSOI increased 168%.

Unlike CSOI, our GAAP operating income include stock-based compensation expense and other operating expense. GAAP Operating income was $464 million compared to a loss of $15 million in the prior year period. Our income tax expense was $266 million. GAAP net income was $92 million or $0.19 per diluted share, compared with a net loss of $126 million or a loss of $0.27 per diluted share.

Turning to the balance sheet. Cash and marketable securities increased $6.02 billion year-over-year to $14 billion. Inventory increased 12% to $7.47 billion and inventory turns were 8.9 turns down from 9.1 turns a year ago as we expanded selection, improved in-stock levels and introduced new product categories.

Accounts payable increased 18% to $12.39 billion and accounts payable days increased to 74 from 71 in the prior year. I'll conclude my portion of today's call with guidance. Incorporated into our guidance are the order trends we've seen to date and what we believe today to be appropriately conservative assumptions. Our results are inherently unpredictable and may be materially affected by many factors including a high level of uncertainty surrounding exchange rate fluctuations as well as the global economy and customer spending. It's not possible to accurately predict demand and therefore our actual results could differ materially from our guidance.

As we describe in more detail in our public filings issues such as settling inter-company balances in foreign currencies among our subsidiaries, unfavorable resolution of legal matters, and changes to effective tax rate can all have a material effect on guidance. Our guidance further assumes that we don't include additional business acquisitions, investments, restructurings, or legal settlements, record any further revisions to stock-based compensation estimates and if foreign-exchange rates remain approximately where they've been recently.

For Q3 2015 we expect net sales of between $23.3 billion and $25.5 billion, or growth of between 13% and 24%. This guidance anticipates approximately 620 basis points of unfavorable impact from foreign-exchange rates, GAAP operating income or loss to be between $480 million loss and $70 million of income compared to a $544 million loss in the third quarter of 2014.

This includes approximately $580 million for stock-based compensation and amortization of intangible assets. We anticipate consolidated segment operating income, which excludes stock-based compensation and other operating expense to be between $100 million and $650 million, compared to a $136 million loss in the third quarter of 2014. We remain heads-down focused on driving a better customer experience through price, selection, and convenience. We believe putting customers first is the only reliable way to create lasting value for shareholders.

Thanks. And with that, Phil, let's move on to questions.

Phil Hardin - Director, Investor Relations

Great. Thanks, Brian. Let's move on to the Q&A portion of the call. Operator, will you please remind our listeners how to initiate a question.

Question-and-Answer Session

Operator

Certainly. Our first question comes from Mark May with Citi. Please proceed. Your line is live.

Mark May - Citi Investment Research

Thanks for taking my questions. You clearly had a lot of things working well in the quarter, but maybe just focusing in on AWS, which seems to be quickly emerging as kid of your largest contributor to operating income. Can you maybe provide a little more color on what drove the acceleration and just the overall growth in the business? If you could talk a little bit about the addition of new customers versus average spend per customer and I think in the past you've talked about what unit growth was for AWS? And in the press release you talked about expanding AWS into some new International markets. Can you give us a feel for how much of AWS' business today is domestic and what kind of opportunity you have there to expand AWS outside the U.S.?

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Yes, Mark. Thanks for your question. We will not be providing the granular customer detail unfortunately but we will say the growth of 81% was up 49% in Q1. You remember that we are lapping a number of large price decreases in Q2 of last year, so it was somewhat expected but a very strong quarter in AWS.

We did announce a region in India. The other thing to mention is that we continue to see very strong usage of growth that's outpacing the revenue growth of 81% obviously. And so, we're really excited about it. From a distribution of customers, it is a global business. We have regions spread throughout the world; we have 11 regions at this point and have announced plans to launch a region in India in the future.

Operator

Our next question comes from Eric Sheridan with UBS. Please proceed; your line is live.

Eric J. Sheridan - UBS Securities LLC

Great. Thank you for taking the question. There has been some recent press reports talking about investments in India. I wanted to know – you've talked a little bit about that market in the past – whether there was any update there in terms of how you think about approaching the market and the level of investments that might be needed to compete in the market? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Certainly Eric. What I can say about India is when we see a positive surprise we double down on it. That's kind of our policy, and India is that kind of surprise. So we're very happy, very encouraged early on with what we've seen in the ramping of the business, the level of invention going on for both customers and sellers. We are over $25 million or excuse me, 25 million names (14:02) which is the largest online store in India. And we continue to improve pricing and fast delivery so were super excited about India. I will not get into specific investment levels right now but we continue to ramp up our investment there.

Eric J. Sheridan - UBS Securities LLC

Thanks so much.

Operator

Our next question comes from Justin Post with Merrill Lynch.

Justin Post - Merrill Lynch, Pierce, Fenner & Smith, Inc.

Thank you. A couple of questions here. We followed this coming for a long time and profits seem to move around quite a bit year-over-year and year against year. And just wondering how you think about that? Is that just the nature of your big bets and that's just going to continue or is there a way to kind of smooth that out?

And then secondly, in AWS it does seem like pricing competition has come down and we've been to a lot of your events and it seems like you're emphasizing pricing a little less to your customers. Can you talk at all about the pricing environment in cloud? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure, let me start with that second question. So, as Phil mentioned, we are seeing continued increases in usage, both sequentially and year-over-year. We are also seeing a great efficiency in the business on a cost basis. Innovation is accelerating, not decelerating. We had over 350 significant new features and services and we believe that's what resonates with customers. While pricing is certainly a factor we don't believe it's always the primary factor; in fact what we hear from our customers is that the ability to move faster and more agiley is what they value. I'm sorry the first party your question was?

Justin Post - Merrill Lynch, Pierce, Fenner & Smith, Inc.

I was asking about just how the profitability kind of really moves pretty big swings year-over-year? Is that the nature of your just big bets and that can continue or is there a way to kind of smooth that out going forward? How do you think about that?

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Yes sure. Well here's how I think about it. We have two things, at least two things going on. We are continuing to drive operational improvement in every business that we are in, but we are also investing in large opportunities that are in front of us, particularly in Marketplace Prime and AWS. If you saw our shareholder letter this year, I think Jeff Bezos put it really well. He said we're going to look for things that are important to customers, customers love them, businesses that can grow to be a large size that can generate a high return on invested capital and are durable and can last for decades. So we will continue to invest in the businesses we think fit that profile and we're always looking for a fourth or fifth business that fits that profile. So as far as lumpiness, admittedly it is lumpy and we will continue to work on both those tracks going forward.

Justin Post - Merrill Lynch, Pierce, Fenner & Smith, Inc.

Thank you.

Operator

And our next question comes from Mark Mahaney with RBC Capital Markets.

Mark S. Mahaney - RBC Capital Markets LLC

Okay. Thanks. I don't know if Tom's listening in. That's a great exit on his part. On International retail you guys had nice acceleration there. Could you give us a little more of the why behind that? Why would International revenue grow, particularly in EGM, accelerate pretty materially. And is that the impact – it's one thesis – is that the impact of kind of the buildup of Prime in International markets and also in the U.S. too, but more spend per Prime customers as they go through this evolution that is just kind of layering on? Is that what it is? What is causing that acceleration? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Certainly. We saw good acceleration in both North America and International this quarter. North America was up 200 basis points sequentially and International was up 800 basis points and half of that you remember we've spoken about the impact of the Japanese consumption tax that was instituted last – April 1 of 2014. It had a measurable impact on our run rate, our growth rate last year particularly Q2. And so we are lapping that, which sequentially makes up half of the 800 basis points sequential gain.

But independent of that, yes, you're right; Prime membership continues to grow. Faster outside, data that we gave at the end of the year. It's growing faster outside the U.S. than it is in the U.S. and we are happy with both growth rates quite frankly. So I would say the Prime membership to Prime flywheel, the additional benefits we are adding to Prime, not only in North America but also Internationally, and additional selection both retail and FBA which feeds the Prime flywheel.

Mark S. Mahaney - RBC Capital Markets LLC

Okay thanks a lot.

Operator

Our next question comes from Brian Nowak with Morgan Stanley.

Brian Nowak - Morgan Stanley & Co. LLC

Great. Thanks for taking my questions. I have two. The first one on the North America retail profitability was up nicely. Can you just talk to some of the drivers of that? Is it more top-line and more Prime subs coming on or is it more on the logistics side and what's driving the North America improving profitability? And then on the International profitability, is there any way you can help us understand the profitability of the more mature International markets like U.K. and Germany relative to the U.S. at this point?

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure. So let me start with North America. 5.1% operating margin was up from 3.9% in Q1 and 3% last Q2. You hit a nail on the head. A lot of it is the top-line growth, but it's also a lot of the efficiency we're seeing, particularly on the fulfillment and marketing lines, which for the whole company were flat year-over-year on a percent of revenue basis. So we are getting very good top-line growth. A lot of that is fueled by Prime adoption and we are dropping a lot of it to the bottom line with many of the efficiency projects.

In International we have not split countries out. What I can say is that if you adjust for foreign exchange the operating margin is up slightly both sequentially and year-over-year. What you're seeing there is also obviously colored by our investment our increased investment in India based on the momentum and the success we've been seeing there so far.

Brian Nowak - Morgan Stanley & Co. LLC

Okay. Great. Thanks.

Operator

Our next question comes from Douglas Anmuth with JPMorgan.

Douglas T. Anmuth - JPMorgan Securities LLC

Great. Thanks for taking the question. Just two things I wanted to ask, First on Prime Day. Brian, if you could give a little more color there on the early takeaways that you have and then also perhaps more importantly how you think that sets Amazon up for the back-to-school season and then also the holidays later in the year? And then also can you just comment on the head count, which I believe is up 18,000 or so sequentially, which I believe is the biggest number that you've ever added in a quarter. Is there anything in particular that stands out there, or just more fulfillment centers, more geography expansion as well? Thanks.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Let me start with that second question first. Yes, head count was up 38% year-over-year. The vast majority of that is in operations where we are adding people for our new FCs and call centers. We continue to look for smart, innovative people who want to build on behalf of customers and – but this particular quarter is colored a bit by the operations growth.

If you look at Prime Day, we're thrilled with the results of Prime Day. It surpassed all of our expectations. Any metric we look at, everything was a huge success. Customers save millions. New Prime members signed up in higher rates than we've ever seen.

People bought more devices than on any other day. So, it's a great success. My hats off to operations team and all the people who worked on that because it was Christmas in July quite frankly, a bigger day than Black Friday, as we've said and orders increased 266% year-over-year. I'll also point out that worldwide FBA unit growth approached 300%, so not only was it a great day for Amazon, it was also a great day for our sellers which is great. So while not breaking out the impact of Prime Day specifically, it's incorporated into our guidance.

Operator

Our next question comes from Carlos Kirjner with Bernstein.

Carlos Kirjner-Neto - Sanford C. Bernstein & Co. LLC

Hi. Thanks for taking my questions. I have two. I may be delusional, but if I add your capital leases and CapEx that suggests that AWS capital intensity is at least 80% if not much higher. What gives you confidence that if AWS continues to grow so fast and consuming so much capital two years out you'll be able to fund its growth from the retail business. And secondly, can you help me understand why you are not ruling out Prime Now and Fresh faster? What specifically are the bottlenecks there? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Let me start with that second one. Prime Now you said, and Amazon Fresh. We are working very quickly on Prime Now. We've now expanded to nine cities, three more in the quarter including our first International city in

London. So, we're moving quick, but we'd always like to move quicker obviously. On AWS I think your question was more around the ability to fund AWS? No comment specifically on that. We do realize it's a capital-intensive business and we have modeling that shows it's going to be a very – it is a very good business for us and that's what we aim for as long-term return on invested capital and free cash flow. So, we're certainly cognizant of the capital part of the calculation, so not much more I can add on that, Carlos.

Carlos Kirjner-Neto - Sanford C. Bernstein & Co. LLC

Thank you.

Operator

Our next question comes from Heath Terry with Goldman Sachs. Please proceed.

Heath P. Terry - Goldman Sachs & Co.

Great. Thanks, guys. I'm wondering if you can touch a little bit more on AWS margins. Is there a level particularly when you've been able to maintain pricing strength the way you have been, where you feel like margins start to become and that the leverage you have there start to become a catalyst for lowering prices? Or is that purely a competitive decision? And as you think about sort of AWS longer-term, is there a framework or structure that you use to think about where margins in that business should be?

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure. Thanks for your question Heath. I will point out that we have continued to lower prices. We've had multiple price cuts this year. We are now up to 49 since launch in 2006, so it is a fundamental part of our business model. So is innovation. As I said, we have over 350 new features and services – also significant features and services that have launched this year. And as we were just talking with Carlos, the capital investment is very large as well, so we continue to fund it. And we are super excited with the customer reception that we are getting and the feedback we get from large customers so we are thrilled with the business.

And price reductions are part of that model. And again, as I said earlier, we're in the long haul. We're in this for the long haul. We are looking for return on invested capital, free cash flow, and happy customers in the space.

Heath P. Terry - Goldman Sachs & Co.

Great, thanks. I really appreciate it.

Operator

Our next question comes from Youssef Squali with Cantor Fitzgerald.

Youssef H. Squali - Cantor Fitzgerald Securities

Thank you. I guess, another question on AWS if I may. So, I want to go back to something that you said, Brian. You said that you've seen greater efficiency in the business from a cost standpoint. I was wondering if you can maybe parse that out a little more for us. Were you referring to OpEx or CapEx? And if you're referring to CapEx as well, do you feel you that you have reached escape velocity that should allow CapEx as a percentage of revenues, pricing aside, to now allow you for a constant decline in that metric, CapEx as a percentage of revenue for that that particular business? Thanks.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

What I can tell you is we have seen great efficiency on the cost side, the cost to generate the capacity for AWS. I will also say that Amazon is one of the primary large customers of AWS so we see it in the consumer side of the business as well, although that's not included in AWS revenue. It's an inter-company relationship. So, we get a double whammy there. We are getting great efficiency from our external AWS business but also from our own use of AWS services.

Youssef H. Squali - Cantor Fitzgerald Securities

Okay thanks.

Operator

Your next question comes from Ron Josey with JMP Securities.

Ron V. Josey - JMP Securities LLC

Great. Thanks for taking the question. Just a quick follow-up on Heath's question, just on the price reductions. Brian, you said earlier in the year, can you just compare the reductions earlier this year versus the ones across the board and from last year in 2Q 2014? And then a follow up just on the third-party units I think you mentioned third-party units are now 45% or maybe 47% of total units. Is there a natural limit there or it doesn't matter as long as the customer experience through FBA is seamless? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Hey Ron. So, I'll comment on the units first. We are really following the model of giving our customers as many choices as possible and letting them choose whether they want to buy first-party or third-party and I think we're working really hard to make sellers succeed on the platform. Brian touched on the success that our FDA sellers had with Prime Day, but we see FBA as a tailwind for third-party business in general.

When we surveyed those sellers in the past, in 2014 about 71% of sellers saw a 20% or greater increase in sales when they entered the FBA program. So we are really happy with what that's doing for third-party business. We're working really hard to give customers as many options as possible and allowing them to choose. And we don't really have a specific target there. It all comes down to customer choice.

On the price reduction question, we've got a long track record of driving costs out of the business and you can certainly see where we've even done that over the last several quarters if you look at the margins in AWS. We've also lowered prices for customers 49 times since launch and so it can be lumpy, but over the long haul that's the model we follow.

Ron V. Josey - JMP Securities LLC

Great. Thank you.

Operator

Our next question is from Paul Vogel with Barclays Capital.

Paul Vogel - Barclays Capital, Inc.

Great, thank you. Just a question on the content side, is there any update on how engaged folks use the video side of Prime and their shopping behavior, number one. And number two, just any update on sort of your plans for growth on the content cost side? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure. On the engagement of the Prime customers, excuse me PIV customers, we have seen buying habits that look like normal Prime customers or other Prime customers from the group that comes in through the digital pipelines, but we do also see a higher pickup in retention rates and free trial conversions. So we're very happy with the linkage between our digital offerings in the Prime customer base.

On the content side, I will say that one of the factors in the sequential guidance Q2 to Q3 being lower, is two things. What we are talking about is the fulfillment center – additional fulfillment center costs that we see this time every year as we get ready for Q4 but also additional step-up in content spend, where we spend a lot of our content in Q3. You will see extensions of a lot of the successful shows that we've had so far this year. A new pilot season including Man in the High Castle and Hand of God so stay tuned for that – or seasons of Man in the High Castle and Hand of God.

Paul Vogel - Barclays Capital, Inc.

Thank you.

Operator

Our next question comes from Gene Munster with Piper Jaffray.

Eugene C. Munster - Piper Jaffray & Co (Broker)

Good afternoon, and congratulations. I just want to follow up on a previous question. In past calls you talked about an increased focus on productivity. Is that still a focus of yours? And separately, any thoughts in terms of how robotics are impacting – any updates in terms of number of robots in fulfillment centers? Thanks.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure thing. Thanks for your questions, Gene. On robotics first, we don't have any new numbers to share with you, but we're super excited with the progress of that business. We had very high expectations for Amazon Robotics and its impact on our warehouse cost structure and we have been very pleasantly surprised by the job being done on that by that team. So that's looking great.

Efficiency, yes. As we've talked about in the last few calls we have even more emphasis on variable and fixed productivity. I think that's evident in the Q2 results that you've just seen. To give you a little more color on that, I would say what does that look like? We have defect reduction and process improvements are probably something we've always done and worked on, both to lower our cost but also to improve the customer experience and also the seller and vendor experience.

We're using software and algorithms to make decisions rather than people, which we think it's more efficient and scales better and will be more accurate, especially as we insert machine learning into the decisions.

As I said earlier we benefit from the efficiency gains of the AWS business on the Amazon site as well.

We look to increase the leverage of our fixed assets, particularly our fulfillment centers and the throughput of the fulfillment centers, and just generally getting inventory closer to customers as we add and expand warehouses in the sort centers that we added primarily last year. All have helped our cost structure, so just a little more color on maybe some specifics on the efficiency area.

Eugene C. Munster - Piper Jaffray & Co (Broker)

Great. Thank you.

Operator

Our next question comes from Brian Pitz with Jefferies & Company.

Brian J. Pitz - Jefferies LLC

Great. Thanks. Now halfway through 2015, any update or insights on your fulfillment center build-out plans for the year? If you can't disclose that, can you maybe just give us a general sense of focus and strategy? How should would be thinking about domestic versus International? As well as sortation versus traditional? What's kind of the path to build that over the next 6, 12, 18 months? Thanks.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure. So we ended the year last year with 109 fulfillment centers around the world and 19 U.S. sort centers. And typically we're looking at what the demand would be for peak as we figure out what we need; so still a little early in the year to comment on that, but in the past we've given an update sometime around Q3 on that. But continuing to build as we have demand. And like Brian said, we like to be close to customers and benefit from having inventory close to customers as well. So like I said, a little early for the update at this point but something we're looking at and something the team's working really hard on.

Brian J. Pitz - Jefferies LLC

Great. Thanks.

Operator

Our next question is from Colin Sebastian with Baird Equity Research.

Colin A. Sebastian - Robert W. Baird & Co., Inc. (Broker)

Great. Thanks and congrats on the great quarter. In the Retail business obviously a lot of variables driving growth there, we're seeing higher Prime membership levels for one, but I wonder how much of that growth you can also break down by some other factors; for example, we're seeing a notable increase in selection across longer tail categories? And then secondly, in the press release, no mention of Fire Phone. I think almost every other product was mentioned. Can we just chalk that one up now to a learning experience and an example of where Amazon is showing some discipline around investments? Or how should we think about that? Thanks.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

So I'll start with the Fire Phone question. We have a policy of not commenting on our roadmap, so can't give you anything there. We obviously do learn from everything we do and value the feedback we get from customers, but nothing to share at this point. In terms of growth, we continue to see selection as a strong driver of growth. Prime is obviously very important as well; we really haven't teased those apart. FBA becomes very important as well and we've talked about some of the tailwinds we see there, and sort of the linkage between marketplace and Prime that FBA provides. So all those things are going on. As you're seeing EGM strength across a lot of the categories there, there was no single category we're really calling out, but continue to see good selection growth and good Prime growth as well.

Colin A. Sebastian - Robert W. Baird & Co., Inc. (Broker)

Thank you.

Operator

Our next question is from Ross Sandler with Deutsche Bank.

Ross Sandler - Deutsche Bank Securities, Inc.

Thanks, guys. So, Brian, I know you guys don't like to provide guidance beyond the next quarter but philosophically if we go back a few quarters you've characterized 2015 as a year where you believe that some of the heavier investments made in prior years should start to benefit and pay off. And we're see – we're clearly seeing that in AWS and in North America retail and it looks like you're still investing heavily on International retail. So if we kind of look out 2016, 2017, is there any high-level philosophical commentary about whether you see next year as another year of these types of trends that you're seeing now? Or are there any bigger investment areas particularly in the retail business that you might be looking to take advantage of?

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Thanks for your question. I can't forecast into the future on that but I will reiterate the investments we have going on right now which again, we're looking to invest to strengthen the Prime platform. That includes video content including Amazon Originals, Prime Music, Prime Now. We have robust device business including the launch of a new Paperwhite Fire TV Echo with general availability and numerous other products that we're very excited about. That roadmap, we know that those devices drive customer engagement and sales. We build fulfillment centers so that we can add selection and we can add FBA partners. And we had things like same-day delivery which we talked about.

On the AWS side we continue to invest in that infrastructure. We talked about opening, announcing the region in India so there's expansion there as well. Future expansion, services expansion Internationally very similar to the U.S. on a number of the Prime fronts but also the investment in India. And then a few other things you may have seen in our press release today, the launch of Mexico which we are excited about and Amazon business.

So lots of – as I said, lots of investment in front of us. But we operate in two paths. We are definitely working for operational efficiencies in the business that we're in. We're investing wisely in things that we think are big and important. And it's not a static activity. We continue to evaluate those investments, take into account what customer response is and make changes. So I think you can look forward to the continuation of that into the future.

Operator

Our next question comes from Kerry Rice with Needham & Company.

Kerry Rice - Needham & Co. LLC

Thanks a lot. You've talked a lot about operational efficiencies. I know you guys have partnered with the post office and deliveries. Can you talk a little bit about how that is potentially benefiting and maybe the longer-term strategy with the post office? And then, you guys haven't necessarily broken this out, but I think you do generate a fair amount of revenue from advertising. I think that's in the other category. Is there anything that you can provide on advertising revenue? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure. So I'll start with the first part of that question. We definitely are delivering a lot of packages with the post office. I think most notably they did a lot of the Sunday delivery that you saw when we started launching Sunday delivery. So we try lots of things for fulfillment. We're constantly working to provide the best experience to customers and be as efficient as possible. And so we're happy with all the partners we have and continue to work with them to provide the best experience possible.

For advertising, I would remind you that certain parts of the advertising roll up into other. Some actually roll up to EGM and media, as well. So it's a business we're really excited about. We're taking a customer centric approach as we build that to make sure we're providing engaging business, engaging adds to customers and making sure we keep the customer front of mind. And it's a business that the team is excited about and working hard on.

Kerry Rice - Needham & Co. LLC

Thank you.

Operator

Our next question comes from Steven Ju with Credit Suisse.

Steve D. Ju - Credit Suisse Securities (USA) LLC (Broker)

Yeah. Thanks. Brian, just to follow-up on the India question earlier. I mean, o my knowledge foreign e-commerce operators such as yourself are not allowed to have first-party retail operations. But given that fulfillment enhance customer service has always been a high focus item for you guys. What steps have you taken in the country to make sure that the consumer experience there is as good if not better for the inventory on which you have no direct control?

And secondarily, similar to China, you have a pretty large population base and Internet penetration growing that's probably comparable to what was the case when you add JOYO – when you acquired JOYO. So can you provide any color on how the general operating environments are the same or different? And do you expect your growth trajectory there to be similar to what you saw in China? Thanks.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

So, your first question was about the infrastructure and how we're managing the customer experience in India. So FBA, Easy Ship and some of those programs are important to us. They're very valuable for sellers to make it easy for the seller to get their goods to the customer. They're great from a customer experience standpoint because we can do what we do best with the logistics. And so there is a lot of investment and a lot of efforts going on that front.

I would say that India and China are totally different. And I think as Brian mentioned, India is a country that we're doubling down on based on the success we've seen there so far. And so very happy with the trajectory we're on there and excited to be investing and have the opportunities we do at that point.

Steve D. Ju - Credit Suisse Securities (USA) LLC (Broker)

Thank you.

Operator

Your next question comes from John Blackledge with Cowen & Company.

John R Blackledge - Cowen & Co. LLC

Great. Thank you. It appears that Amazon is growing its share of household budget driven by many factors, Prime growth and strong growth in large verticals like apparel among others. Specifically on apparel, I'm just wondering how you view the breadth of Amazon's apparel offering. Any color on that segment's performance in the second quarter. And how do you view Amazon's apparel opportunity going forward? Thank you.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Yeah. Thanks for your question. We have not broken out specifically apparel, but we're super excited about that business. It's growing very well. We like our position in it. We think our website is very tuned to selling online. So we're very happy with that. It is a big business for us, not only in North America but also Internationally. You mentioned a couple other consumables categories. I will say we are very happy in our consumables and hard lines categories, as well. We drive a lot of repeat business with things like Prime Pantry and Subscribe and Save and others. So, very happy with the EGM business as a whole.

John R Blackledge - Cowen & Co. LLC

Thanks.

Operator

And your final question comes from Scott Tilghman with B. Riley.

Scott Tilghman - B. Riley & Co. LLC

Thanks. I wanted to just follow up on a couple things. Three quick questions, first off on International I was wondering if you could compare and contrast relative performance of media and EGM? You're moving in different directions. Second, there have been a couple questions about shipping but most notable is that we had a couple price increases from the majors hit at the beginning of the year and it seems like you're costs are coming down. I was wondering if you could comment on that. And then third, just following up on Brian's question around the FCs. I was wondering how many of the facilities lend themselves to expansion rather than having to put up a new facility? Thanks.

Brian T. Olsavsky - Senior Vice President and Chief Financial Officer

Sure. Let me start with the first question on International media and EGM. I think we are seeing similar trends in both geographies, those segments that EGM growth is very strong media growth has been consistent for the last four quarters. We do like the work being done by media teams. There's a lot of pipeline of invention: things like Prime Instant Video, Prime Music; all feed the Prime pipeline and Prime ecosystem, if you will. They work great with our devices by the way. They drive other non-media sales.

They are very tied together, although certainly the EGM is outpacing the media segment or media businesses right now. On transportation costs, not a lot to add there. Again, the combination of doing our own shipping and using third-party carriers so the rate increases are staged and we see those quite frequently, so nothing to add there. On the FCs and whether we would expand or build new, I think we are looking to always get the most out of the fulfillment centers that we have and as we need new facilities we place them closer and closer to customers so that can have its benefits as well, but not much more to add on that one.

Phil Hardin - Director, Investor Relations

Thank you for joining us on the call today and for your questions. A replay will be available on the Investor Relations web site at least through the end of the quarter. We appreciate your interest in Amazon.com and look forward to talking to you again next quarter.