Barclays Capital Global Technology Conference

Company Participants

- Tom Szkutak, SVP and CFO

Other Participants

- Doug Anmuth, Analyst, Barclays Capital Inc.
- Unidentified Participant, Analyst, Unknown

Presentation

Doug Anmuth

All right. So we're going to get started here with Amazon.com. I'm Doug Anmuth, the Internet analyst at Barclays Capital. It's our pleasure to have Amazon and Tom Szkutak, CFO of Amazon since 2002. Prior to that, Tom spent 20 years with GE; he's the CFO of GE Lighting, also in other various executive roles in GE Plastics and GE Investments. So with that, we'll turn it over to Tom.

Tom Szkutak {BIO 5025269 <GO>}

Thank you. Good morning. This presentation may include some forward-looking statements. For a full list of our risks and uncertainties, please see our most recent 10-Q and subsequent filings.

The agenda for this morning -- I'm going to talk about our results and our strategy. Our financial focus -- we focus on maximizing profit dollars, not individual margins. We optimize free cash flow per share. And we think with our model, we'll have high sustainable return on invested capital over time.

Here's a look at free cash flow. If you look at the right hand side of this chart, you can see the free cash flow as of the end of Q3 on a trailing 12-month basis with $970 million. That's up 21% year-over-year. Again, our goal is to optimize free cash flow per share.

Here's a look at the pieces. I like to look at it this way so you can see the individual pieces. You can see our GAAP operating income on the left. You can see two circles in the middle of the page. You can see our change in Accounts Payable and change in inventory. So as you can see from this slide, over the past 12 months, we've actually generated cash from working capital. You see the $259 million.

Also, our reinvestment ratio -- or our CapEx versus depreciation is approximately one. You can see that our CapEx is just over one -- $305 million versus $273 million of depreciation. So again, you can see the leverage in earnings and working capital while keeping our fixed investment relatively flat.

Here's a look at our operating cycle. As you can see from this slide, the way you'd read this is we have approximately 29 days worth of inventory on hand. We have several days' worth of receivables and we pay our suppliers, in this case, on an average of 55 days. That means we have a negative operating cycle of 21 days. So it's, again, as we grow, as I showed from the previous slide, working capital as a source of cash.

Share count. We're efficiently managing dilution. If you look at the right hand side of this chart, you can see shares -- stock-based awards outstanding plus common shares outstanding total $448 million. That's up from $435 million. You can see the history going back to 2003.

Net sales. Net sales over the past 12 months are $18.1 billion, up 38% year-over-year or 33% on a local currency basis. And you can see the trend going back to 2003.

The way we look at our results -- we have two principal segments -- North American and International. We also break out our sales between media, electronics and other general merchandise and other. Other includes Amazon Enterprise Solutions, which is where we power a third party website, Amazon Web Services, our co-branded credit card. And other miscellaneous marketing agreements.

Here's what the mix looks like. If you look at the left hand side, it's a five-year look. So if you look at the left hand side, you can see what our mix looked like back in 2003, at the end of Q3, on a TTM basis versus where we are in the most recent quarter, again on a TTM basis. If you look at the slide, you can see media with 78% of our business five years ago. It was $3.7 billion. That media revenue grew from $3.7 billion to just under $10.8 billion. But it declined as a % of our total revenue from 78 -- (70%) to 59%.

You can see that our Electronics & Other General Merchandise grew from $951 million to $6.9 billion during the period, or grew from 20% of our total to 38% of our total; so, again, becoming more diversified in the past five years.

If you take a look at the split by segment, this is what it looks like. Again, top half is North America, bottom half is International. Top half you can see our North America revenue, media revenue grew from just under $2.2 billion with 71% of our revenue grew to $5.2 billion or 54% of our revenue. And EGM grew from $800 million to $4 billion during the period or 26% to 42% of our total.

And if you look down at the bottom half of the page, you see International. We were really a media category business in International back in 2003; 92% of our revenue came from media. We had $135 million of revenue back in 2003 in International. That

-- EGM grew from $135 million to $2.8 billion over the past five years; went from 8% to approximately 33%. Even though our media business was 92% of our International business, it has grown significantly also from $1.5 billion to approximately $5.5 billion during the period.

Here is another look at International sales. You can see from this slide, Q3 on a TTM basis was up 43% or 32%, excluding impact from foreign exchange rates. This represents our sales from our sites in UK, Germany, France, Japan and China. You can see that it's 47% of our total revenue on a TTM basis as of Q3. It's growing. We certainly could expect to see this greater than 50% over time.

We also ship to more than 200 countries. That comes from our various websites, including North America as well.

Gross profit. The bars are gross profit dollars per lines of gross margin. You can see that our gross profit was just under $4.1 billion at the end of Q3 on a TTM basis. That's up just over $1 billion from Q3 of '07. Again, our objective is to maximize gross profit dollars and on individual margins.

Here's a look at our Consolidated segment operating profit -- same look. Again, the bar chart is the dollars, the line of the percentages. Again, over the past 12 months, our Consolidated segment operating income was just under $1.1 billion, up from $749 million a year ago.

Here's a snapshot of our balance sheet. As you can see from this chart, we have total assets of just under $6.6 billion. We have cash and marketable securities of just over $2.3 billion; inventory of $1.3 billion; return on inventory, approximately 12 times, estimate of 12 to 12.4 range for a number of quarters. You can see our fixed assets are approximately $700 million.

You see the long-term debt and other, $895 million, approximately EUR240 million of that is our remaining principal piece of corporate debt. It's our euro-denominated debt that's due in 2010. And so you can see that we have I think a strong balance sheet and we can see that the (amounts) demonstrating its efficiency.

Return on invested capital -- return on invested capital over the past 12 months, again, is 32%. The way we calculate return on invested capital is conservative. We take annual free cash flow or trailing 12-month free cash flow divided by total assets minus current liabilities on a 5 point average basis. And again. So cash and marketable securities, the $2.3 billion from the previous page is part of the denominator -- whatever that cash balance on average was over the five quarter period is part of the denominator.

So that's it for the results. What I have now is a number of slides around our strategy. We want to be the earth's most customer-centered company. We always start with the customer first and work backward. We have three customer sets that I'm going to talk about this morning. One is the consumer; one is sellers; and the other is developers. I'll walk through each of those.

First, our virtuous cycle. And let me walk you through this; this is kind of busy. We start with adding selection. This is how we think about our seller -- our consumer business. We start with selection. We do a number of things to improve customer experience and that drives traffic to our individual detail pages and to our website.

As traffic continues to increase, it becomes more attractive for third party sellers to sell on our detail pages. Then as we grow, we're able to leverage our overall cost structure and lower prices. And again, continue to invest in customer experience. We have over 84 million active customer accounts, up 17% year-over-year.

There's a number of ways that we leverage our platform. I'm going to talk about a few of those. We have Amazon.com, which is -- Amazon.com is a seller in each of our marketplaces around the world. 69% of the units as of Q3 came from Amazon.com as a seller. That's where we have our inventory on our product detail pages.

We also have a number of third party sellers. That's where it's the seller inventory on our product detail pages. As of Q3, that was 31% of our units.

Then we have Amazon Enterprise Solutions or what we had called before, it was merchant.com. Again, that's where we use our technology to power third party websites.

Then we also have Amazon Web Services, where we have Web scale computing and we have a number of simple APIs. Again, starting with taking technology that we've used for ourself, leveraging it with sellers, using it for third parties. And developing APIs for external use as well.

We think about our consumer customer experience pillars in three areas -- price, selection. And convenience. Innovation is the foundation of each of these.

Pricing. Our objective is not to discount a small number of products for a limited period of time. But to offer low prices every day and apply them broadly across our entire product range.

Selection. If you take a look at this slide, on the left hand side, you see our individual product categories. And on the top, going across, you see our various country websites. The dates that you see in the individual -- by the individual categories and geographies are the dates that we launched those particular categories. So you can see from this slide, there's still a lot of open white space. And the way you should think about it is those are opportunities for the future.

There's still a very large opportunity, we think, in adding selection in the existing categories that we're in today -- even the ones that we launched back in mid to late-

'90s. We're still adding selection to those individual categories.

We think there's opportunity to add more geographies over time. And we also think there's opportunities to add categories that are not on this page. So again, from a selection standpoint, as we think about growth -- add more geographies; add selection within the categories that we're in; add new categories with geographies that we don't have today; and add categories that are not on this page. So again, a large amount of room for -- to add selection.

There's a number of different ways that we add convenience for customers. I'm just going to walk through a few examples. This happens to be Amazon Prime. The way Amazon Prime works is you -- we have this in a number of geographies, as I'll show you in a few minutes -- but we charge a fee and then we have unlimited, express two-day shipping.

So if you're a customer in the US, you can share it with a few family members, the actual subscription. Then you can ship product to anywhere in the US for free express two-day. So that's the way it works. Then you can also ship next day for $3.99. So again, it's a great convenience for customers.

If you take a look at this slide, you can see -- on the left hand side, you can see the individual geographies that we're in. You can see that we have a prime subscription membership program in most of the geographies. We do not have it in Canada or China, not yet today. But we do offer free shipping in all of our geographies. And if you look closely, you can see the annual fees, the dates they were launched -- and in this case, prime -- and what the offering is.

So again, we have two-day free shipping in the US. We have free one-day shipping in UK and Germany. We have free expedited either same or next day in Japan. And recently launched free one-day delivery in France.

One of the other convenience items we're offering is frustration-free packaging. We have a number -- we're working with a number of suppliers to offer this. And again, it's a way to offer, in this case, the toy category to get rid of a lot of the frustration-free packaging. That's also, obviously, much more economically -- excuse me, environmentally-sensitive. And so we think this is a great convenience for customers. And it's something that we're very proud to be working on.

Another convenience segment -- we have a separately branded website called Endless. It's our shoe and hand bag website. It has some very special features to it. If you haven't been on it, I encourage you to take a look at it. We offer overnight shipping for free on the separately branded website and free returns. And again, it's a very interesting site for our shoes and it's specifically designed for shoes and hand bags. We've had this launched in the US for some time. And we launched recently in Japan.

Kindle. We have a number of different digital offerings. Kindle is our digital text offering. And we're excited with the progress that we've had so far with Kindle. And again, it's a wireless reading device. And you can get many, many different books, magazines. And newspapers delivered electronically in under 60 seconds, right at your fingertips.

One of our other digital offerings is MP3 downloads. We just recently announced that we've launched that in UK in addition to our US website.

Video on Demand is another offering that we have. Again, one of the things that we're trying to improve from a customer experience standpoint is -- we offer great selections, great pricing; how do we get product to customers now, for those customers that really wanted to get product now? And so, with Kindle, you can get books, magazines and newspapers almost instantaneously. The same thing with MP3 and Video on Demand.

Holiday toy list. This is an interesting feature. I encourage you to go on and look at it. It's just an adaptive way to look at a holiday toy list. And again, it's a convenience for customers. And probably the best way to see this is to actually go on the site and take a look at it.

So that's consumers. What I thought I'd do now is spend a few minutes talking about sellers.

This is a screenshot from one of our detailed pages on our website. You can see that it's a Blu-ray disk player. If you look closely, you can see the circle on the right hand side, you can see that it's offered from a merchant other than Amazon.com. So this would be if a unit sold through this particular detail page, it will be one of the 31% of total units that we added in Q3.

And the way this works is, we call this particular seller -- won the buy box. And what we allow branded sellers to do is if they have the best pricing and the best availability, we allow them to win that buy box. And what that means is they're shown prominently first in the buy box, as you can see, in that blue box on the top right hand side.

There's also more buying choices listed below if you happen to want to buy it from a different seller. So again, it's a feature; it's a marketplace, a competitive marketplace on our detailed pages. And in this particular case, this particular seller had the best pricing and availability.

We like this because there's certainly times where you might have a seller that has -- it's a great way to add selection. It's also a great way for customers to show that it's an incredibly competitive marketplace. So they can choose who they want to buy from. From time to time, you'll have sellers that may have excess inventory; they might be deeply discounting a particular offer. We're very happy to have them sell that product on our detailed pages and earn a commission on it. We have over 1.4 million active sellers, which is up 17% year-over-year.

So this is a slide on our sellers. As you can see -- and also the lines are the percentage of total units. As I mentioned, we have over 1.4 million active sellers. That's up from over 1.2 million last year. And you can see the trend back to 2004.

There's a number of different things we're doing to try to improve the seller experience. And this just happens to be one example -- it's called Fulfilled by Amazon. It's pretty simple in concept. The way it works is we have sellers who we will do fulfillment for. They ship in bulk to us. And we will provide fulfillment for those sellers and for those customers.

And so, the advantage from a seller perspective is they get to take advantage of our multi-node Fulfillment network. If you go on our website. And you were to find -- you'll find a number of these. And you'll see them shown as -- there's a little box that says Fulfilled by Amazon. So the customer knows that it's something that we're taking care of the fulfillment for.

The benefit to the seller is they get to offload that activity to us. They also get the benefit of participating in our various shipping programs. For example, free Super Saver Shipping will be available on these items. Amazon Prime, Express two-day delivery will be available on these items. And so it's a great way from a customer standpoint to get more selection, additional selection that's available on Amazon to be part of the Prime and free shipping programs. And it's great for sellers as well. So we think it's great for investors, great for sellers. And great for customers.

Amazon Enterprise Solutions -- we have a number of examples. And I show a few examples on this slide, where we actually power third party websites today using our technology. So it's a great way for us to take advantage of the technology that we've developed and offer it to others to monetize that.

Checkout by Amazon. We have certainly improved and have great capabilities from a payments perspective on our website. And we're offering those services externally as well for third party providers.

Amazon Web Services. The way we think about Amazon Web Services is we take -- it's a great way to take -- develop and take their idea; they can offload the undifferentiated heavy lifting, if you will, which we'll do for them. And that's work that we're doing for ourselves anyway, to lead to a successful product.

We have a number of different Web services. This just happens to be a list of the ones that we have.

In summary, we have -- certainly we think that the online model is advantaged. We face many challenges and many opportunities. But we're relentlessly improving the customer experience for our three customer sets -- consumers, sellers. And developers.

We're leveraging the platform wherever we can. The examples I gave around leveraging the technology for ourselves versus retailer for sellers -- powering third party websites and Web services. We think we're well-positioned for growth. And we're focused on optimizing long-term free cash flow per share. And innovation is the foundation of everything that we do.

Thanks for listening. I think we have a few minutes for questions.

Questions And Answers

Q - Doug Anmuth

Great. All right. I'll kick it off. Tom, you talked a lot about free cash flow. And so, I guess in particular, thinking about the working capital benefits during this time, where we were expecting the top line to just slow somewhat. And then grow in obviously CapEx as well, putting some pressure on those benefits. The question is, do you see any structural change there in terms of the working capital cycle, where suppliers are looking for payments any sooner in this environment? And is it reasonable to think that working capital benefits come right back as your sales do when we come out of this environment? Thanks.

A - Tom Szkutak {BIO 5025269 <GO>}

The question was again around working capital -- do we think there's any major changes?

I think -- structurally, I think over time, the working capital benefit that we get or the negative operating cycle is going to be with us. Certainly, you see some differences by category. Certainly, there's some categories that have larger -- it's similar to the gross margin discussions that we've had in the past; just some categories have higher gross margin, lower gross margin.

Same thing with operating cycles. Some have higher and lower operating cycles. But to answer your question, I think certainly over time, we think that this is a structural benefit.

And it's really around the biggest benefit is because we turn our inventory so quickly. We have the benefit of when you're turning your inventory 12 times, while adding a lot of selection and getting very deep in selection and improving in-stock levels, it will turn it that quickly. That's really where the benefit comes into play.

And so, whereas physical world retailers, you have to have -- if you have 500 stores, for example, across the country, to have good in-stocks, you have to have good in-stock to 500 stores. We're able to keep that inventory in a smaller number of locations. And we turn it very quickly. So that's where the advantage comes in, in the operating cycle.

Q - Unidentified Participant

Can you just talk a little bit about the Fulfillment business? And what the trends are there and whether or not you've seen improvements or rather issues with holding more inventory for your customers?

A - Tom Szkutak {BIO 5025269 <GO>}

Yes. We think it's a -- your question was around the Fulfillment business, Fulfilled by Amazon. And how we are seeing the trends. We're actually very happy with the trends that we've seen. And we published, at the end of Q3, the units associated with that, if you can go back to our release and take a look at the exact details of that.

It's still a very early program for us. It's something that we think a number of years out and what it would look like. But we think offering our multi-node Fulfillment network to sellers so that sellers can concentrate on procuring product and making sure that they -- all the things that they need to do on their side while offloading that to us will be a benefit.

It won't be for everybody, certainly. But if you think about a seller that's selling on a website today, then they get the opportunity to participate in our free shipping program, it's just a great benefit to them in addition to knowing that -- having a customer know that we're the ones providing the fulfillment. So I think it's just a -- it's early. But it's something we find interesting and we think we're hopeful that it will be big for us over time.

Other questions?

Q - Unidentified Participant

All right. Could you talk a little bit about the payment product, the Checkout by Amazon? What kind of success you're seeing in terms of adoption both by customers and third party vendors?

A - Tom Szkutak {BIO 5025269 <GO>}

Right. It's another one that's -- again, we have a few offerings there. Those are, again, very, very early. But again, the thought around it is -- it takes a lot of time on various websites and you have to have a really secure environment, which we do, to put in all your credentials. And so it's a great way to use our product and leverage what we've worked on for, really, since inception. And have third parties use that payment product.

So it's extremely early. And we'll have to see how it works out. But we like what we see so far. And again -- but it's very early.

Okay. I think we have time for maybe one more question and that's -- no more questions? Okay. Thank you very much. Oh, one more question.

Q - Unidentified Participant

Have there been any changes in renewal rates for prime in tougher economic times?

A - Tom Szkutak {BIO 5025269 <GO>}

That's a good -- it's a good question. We're certainly -- we'll be monitoring it as we go. Right now the renewal rates are very high and we'll monitor it as we go. But it's something that -- our finding is, it's such a great convenience for customers, in addition to -- just once a customer is a prime member and starts getting things express two-day for free, it is something that's very difficult to get off of once the customer is doing it, because it's just a great service. So it's something that we're monitoring very carefully. But the renewal rates are good.

So thanks for the questions -- great questions.