

Operator

Good day everyone, thank you for standing by. Welcome to the Amazon.com First Quarter 2013 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 the Vice President of Investor Relations, Mr. Sean Boyle. Mr. Boyle, please go ahead.

Sean Boyle

Hello and welcome to our Q1 2013 financial results conference call. Joining us today is Tom Szkutak, our CFO. We will be available for questions after our prepared remarks.

The following discussion and responses to your questions reflect management's views as of today, April 25, 2013 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 2012.

Now, I'll turn the call over to Tom.

Tom Szkutak

Thanks Sean. I'll begin with comments on our first quarter financial results. Trailing 12-month operating cash flow increased 39% to \$4.25 billion. Trailing 12-month free cash flow decreased 85% to \$177 million. Trailing-12 month capital expenditures were \$4.07 billion.

This amount includes \$1.4 billion in purchases of our previously leased corporate office space, as well as property for development of additional

corporate office space located in Seattle, Washington which we purchased in the fourth quarter 2012.

The increase in capital expenditures reflects additional investments in support of continued business growth consisting of investments in technology, infrastructure including Amazon Web Services and additional capacity to support our fulfillment operations.

Return on invested capital was 1%, down from 12%. ROIC is TTM free cash flow divided by average total assets minus current liabilities excluding the current portion of long-term debt over five quarter ends. The combination of common stock and stock-based awards outstanding was 471 million shares compared with 464 million one year ago.

Worldwide revenue grew 22% to \$16.07 billion or 24% excluding the \$302 million unfavorable impact from year-over-year changes in foreign exchange rate. We are grateful to our customers who continue to take advantage of our low prices, vast selection and shipping offers.

Media revenue increased to \$5.06 billion, up 7% or 10% excluding foreign exchange. EGM revenue increased to \$10.21 billion, up 28% or 30% excluding foreign exchange. Worldwide EGM increased to 64% of worldwide sales, up from 60%.

Worldwide paid unit growth was 30%. Active customer accounts exceeded 209 million. Worldwide active seller accounts were more than 2 million. Seller units represented 40% of paid units.

Now, I will discuss operating expenses excluding stock-based compensation. Cost of sales was \$11.8 billion, or 73.4% of revenue, compared with 76.1%. Fulfillment, marketing, technology and content and G&A combined was \$3.83 billion, or 23.8% of sales, up approximately 289 basis points year-over-year. Fulfillment was \$1.74 billion, or 10.8% of revenue compared with 9.5%. Tech and content was \$1.26 billion, or 7.9% of revenue, compared with 6.5%. Marketing was \$616 million, or 3.8% of revenue compared with 3.6%.

Now, let's talk about our segment results and consistent with prior periods, we do not allocate the segments, our stock-based compensation or other operating expense line item.

In the North America segment, revenue grew 26% to \$9.39 billion. Media revenue grew 14% to \$2.51 billion. EGM revenue grew 28% to \$6.13 billion, representing 65% of North America revenues, up from 64%. North America segment operating income increased 31% to \$457 million, a 4.9% operating margin.

In the international segment, revenue grew 16% to \$6.68 billion. Adjusting for the \$301 million year-over-year unfavorable foreign exchange impact, revenue growth was 21%. Media revenue grew 1% to \$2.54 billion, or 7% excluding foreign exchange and EGM revenue grew 28% to \$4.09 billion, or 32% excluding foreign exchange. EGM now represents 61% of international revenues, up from 56%.

International segment operating loss was \$16 million, a 0.2% negative operating margin compared with income of \$49 million.

CSOI increased 11% to \$441 million, or 2.7% of revenue, down approximately 27 basis points year-over-year. Unlike CSOI, our GAAP operating income includes stock-based compensation expense and other operating expense. GAAP operating income decreased 6% to \$181 million, or 1.1% of net sales.

Our income tax benefit was \$18 million it includes \$46 million of discrete tax benefits primarily resulting from the retroactive reinstatement of the federal research and development credit that was enacted in January 2013. GAAP net income was \$82 million or \$0.18 per diluted share compared with \$130 million and \$0.28 per diluted share.

Turning to the balance sheet, cash and marketable securities increased \$2.18 billion year over year to \$7.89 billion. Inventory increased 27% to \$5.4 billion and inventory turns were 9.5, down from 10.4 turns a year ago as we expanded selection, improved in stock levels and introduced new product categories. Accounts payable increased 29% to \$8.92 billion and accounts payable days increased to 68 from 62 in the prior year.

I will conclude my portion of today's call with guidance. Incorporated into our guidance are the order trends that we've seen to date and what we believe today to be appropriately conservative assumption. 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 consumer spending. It's not possible to accurately predict demand and therefore our actual results could differ materially from our guidance, as we've described in more detail in our public filings issues such as settling intercompany balances in foreign currencies among such subsidiaries, unfavorable resolution of legal matters and changes to our effective tax rates can all have a material effect on guidance.

Our guidance further assumes that we don't conclude any additional business acquisitions, investments or settlements, record any further revisions to stock-based compensation estimates and that foreign exchange rates remain approximately where they have been recently.

For Q2, 2013 we expect net sales of between \$14.5 billion and \$16.2 billion, a growth of between 13% and 26%. This guidance anticipates approximately 275 basis points of unfavourable impact on foreign exchange rates. GAAP operating income or loss to be between a \$340 million loss and \$10 million income compared to \$107 million income in the prior year period. This includes approximately \$340 million for stock-based compensation, amortization of intangible assets.

We anticipate consolidated segment operating income, which excludes stock-based compensation and, other operating expense to be between zero and \$350 million compared to \$360 million in the prior year period. 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. With that, Sean, let's move to questions.

Sean Boyle

Great. Thanks Tom. 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. (Operator Instructions) And our first question today will come from analyst Brian Pitz with Jefferies.

Brian Pitz - Jefferies

In February, you changed your FBA fulfilment fees. Any comments on how this affected third-party sales and what was the overall merchant response? And then just quickly any update on your latest plans for new fulfilment centers in 2013?

Tom Szkutak

In terms of -- I will take the second part of the question first, in terms of new fulfilment centers, we've announced three in the US right now and then a few outside of the US consistent with the prior year. It's early -- we really like the growth that we are experiencing. We will be adding more of these through the course of the year but stay tuned, we will update you as we go.

In terms of FBA, there's not a lot I can talk to there. We are very pleased with the FBA business and we think it's great for sellers and great for customers. And we are pleased to offer that service.

Operator

Moving on, we will hear from Scott Devitt of Morgan Stanley.

Scott Devitt - Morgan Stanley

Tom, the international segment sales growth of 21% continues to show modest deceleration I think with the exception of 4Q, it's been trailing US growth. I understand that AWS is mostly booked in the U.S. so that's a piece of the delta. But you've talked in the past quarters about the investments in international driving margin to at least breakeven levels in international. I wonder if you could just talk through deceleration in the revenue growth in those markets and whether that's comp related Europe macro or otherwise?

And then secondly, shipping cost on a net basis is again leveraging. I think that's a second consecutive quarter. I just wonder if you could refresh us in terms of when the accounting change occurred in terms of the shipping revenue calculation for FPA to just understand if that's an organic number now. Thank you.

Tom Szkutak

The second half of the question, there is -- it is organic. So there is no -- it's consistent year-over-year. So this is the first quarter. It will be consistent year-over-year. In terms of your question, international, we're seeing still very solid growth, 21% on a local currency basis. As you've read, certainly there is some softness from a macro standpoint that others are saying are hard to know whether that's impacting us and how much we're not a bellwether for the economy.

But we're very pleased with the growth that we're seeing. Again 21% on a local currency basis, unit growth is actually growing substantially faster than that. So again that's what we're seeing. In terms of investing, you're absolutely right.

We're investing in a number of geographies including certainly China. We've been investing for several years. We continue to invest there. We think it's a great long-term opportunity but we're in investment mode. And certainly some of the more recent additions that we've had with Italy and Spain are certainly in investment mode as well.

Scott Devitt - Morgan Stanley

Thank you.

Operator

Thank you. Moving on, we will take a question from Mark Mahaney of RBC capital Markets.

Mark Mahaney - RBC capital Markets

Thanks. It's just a broad question on demand that's kind of mid-teens at the low-end revenue growth that you've been, kind of, guiding too for, a quarter or two now that we've seen well below the -- the average that you've seen in the past. Are there any other factors you would want to call out or specifically not call out?

Do you think that things like imposition of state sales tax are having in near-term drag on growth rates. Last quarter, I think you talked about consumer electronics at the high-end. Are there any particular categories there you would want to call out as maybe driving that low -- that could produce low-end of the range outside of negative FX? Thanks.

Tom Szkutak

Sure. We give -- as we're consistently doing, we're giving a wide range. We think it's appropriate, given all the factors that's not something new that we're doing. That's something that have been doing for some time in your right -- growth rate guidance for Q2 is 13% to 26% certainly foreign exchange having an impact that includes approximately 275 basis points of foreign exchange. So it's approximately 16% to 29% on a local currency basis.

So again it's a wide range and just probably not a lot to add there but it takes into account all the things that we think we need to take into account as we give guidance. In terms of the absolute dollar range, it's very similar to what we would have -- in terms of the dollar range we would have given for Q1. I think it's maybe \$100 million difference in terms of the absolute value of that range that we gave. So again wide range, we think that's appropriate.

Mark Mahaney - RBC capital Markets

Thank you.

Operator

Our next question today will come from Ben Schachter of Macquarie.

Ben Schachter - Macquarie

Are there any factors that are impacting the unit growth, particularly the shift from physical to digital, for instance rented video versus purchasing of

video. Are there any other factors that you would highlight that are impacting the unit growth?

Tom Szkutak

The one factor, I would call out, first of all in terms of overall unit growth. Overall unit growth is 30% year-over-year. Again, very solid growth, compares to approximately 49% of Q1 of last year. So it's certainly -- we're certainly overlapping a pretty strong growth of last Q1.

In terms of the physical and digital, certainly one thing that we're seeing is certainly digital growing at a much faster rate. And when you do see that, a little bit is in our third-party units as a percentage of total units. You will see that, that's approximately 40% this quarter. That compares to last year up about approximately 100 basis points. But what we're seeing is because the digital units are growing at a faster rate and that mostly first party you're seeing that number impacted where that percentage as a percentage of our total is not growing as fast as it has last few quarter. Again that's largely driven by the digital units growth that you are seeing.

So again that's -- if you were to back out, for example, and just look at our physical units, our physical units as a percentage of total units this year versus last year is up over 300 basis points. That's again 3p growth as a percentage of total units.

Operator

Our next question today comes from Ross Sandler, Deutsche Bank.

Ross Sandler - Deutsche Bank

Question on the -- follow-up question on the shipping, so just your net shipping costs, not your shipping margin, but just shipping costs relative to gross profit declined about 300 basis points, similar to what you have seen over the past four quarters. So as you start to comp some of these efficiency gains that you are seeing in shipping, do you think that line will continue to show leverage or is it going to start to level out from here?

Tom Szkutak

We are not giving -- certainly we're not giving guidance on any specific line item but certainly over a long period of time we think there is opportunity to be more productive there, and there are certainly efficiency gains to be had there. And that's something, certainly the team continues to work on.

Operator

Next, we will hear from Colin Sebastian of Robert W. Baird & Company.

Colin Sebastian - Robert W. Baird

Just a question on what services -- wonder if you can comment on enterprise level adoption, whether there are any meaningful barriers to that happening over time. We notice you've been pretty aggressive in hiring enterprise-level sales people?

Tom Szkutak

No, I don't think that there is. I think the team has done a fantastic job in terms of developing services that are great for many different customer types, including enterprises. And the team is heads down focused on making sure we have a great operational of these services that are great from an operational standpoint and security standpoint and they are doing a terrific job. And so it's a very great opportunity for enterprises to adopt our services and the team is certainly focused on that along with other customers. So other customers that took in, it's a great opportunity for those customers and for us.

Operator

Our next question comes from Douglas Anmuth of JPMorgan.

Douglas Anmuth - JPMorgan

You've clearly been more aggressive in terms of video content recently and you are sort of leading, was it more in the release tonight in terms of the business content. I was hoping you could just add some more color here on the value that you think TV and movie content adds to consumers' overall purchase patterns?

Tom Szkutak

Sure. It's certainly one of our digital offerings and we have a number of different services. We have certainly content that we're using as part of our prime offer that we have a lot of free content of the customers. We think that's a great service to customers along with our express shipping offers as well as other content that we have free, for example, our Kindle owners lending library for books. So again, we think it's a great -- finds a great value for customers and it's part of that value proposition. We also have in a very good transaction business for video as well. That's growing very, very fast and certainly customers like it. We are seeing that reflected in the result that you see today.

Operator

Moving on, we will hear from Justin Post with Merrill Lynch. Mr. Post, your line is open. Please go ahead with your question.

Justin Post - Merrill Lynch

Sorry about that. I was on mute. I was wondering if you can help us little bit about the Kindle ecosystem. On prior calls a few years ago, you singled it out as a fast growth area and you were very happy with the performance. We haven't heard as much about it lately. Kind of the impact -- sort of how units are doing against your expectations and then the impact it's having on prime subs and also your growth in operating margins? Thank you.

Tom Szkutak

We are very pleased with Kindle and digital business. And we are superexcited in terms of the ecosystem. You're certainly seeing that in our results that you see today. For example, if you look at our media growth, we are certainly -- that ecosystem is more penetrated there than it is in international and you see that reflected in those associated growth rates.

Another way you see it is, if you take a look at our top 10 best-selling items worldwide in Q1. The top 10 are all either digital or Kindle related. Paperweight is our best selling product worldwide. But again, all 10 spots in the Q1 were either Kindle or digital items. And I believe that that's the first time that we've seen.

We've been looking at that from a quarterly results standpoint for some period of time, and we've had various levels of the top 10. But I think this maybe the first quarter we've had all top 10 being either Kindle related or digital related. So again, we are very pleased with what we were doing there and we are going to continue to innovate on behalf of customers.

Justin Post - Merrill Lynch

And any impact on your gross or operating margins you recall?

Tom Szkutak

One thing I would say is we certainly are investing, certainly in area of investment and you're seeing that reflected. We are making a number of investments across the business and certainly we are investing in Kindle and our digital offerings. We are investing in some of the things I mentioned earlier like China or some of the emerging geographies. So those are certainly some of the larger key investments we are making.

Justin Post - Merrill Lynch

Thank you.

Operator

Moving on, we will hear from Matt Nemer of Wells Fargo Securities.

Matt Nemer - Wells Fargo Securities

Afternoon. We are hearing reports that there is refrigeration equipment going in some of your fulfillment centers outside of Seattle area. Just wondering if you can update us on plans to expand AmazonFresh. Thanks.

Tom Szkutak

Nothing to announce here. We are very pleased with what we've seen in the Seattle area. But against, it's been a test and we continue to monitor that test carefully. It's certainly something that we see that customers love the experience. The challenge has always been in making sure we get the economics right and that is something we will continued to focus on.

Operator

And up next, we will take a question from Steven Ju of Credit Suisse.

Steven Ju - Credit Suisse

Hey. Tom, anything you can say in terms of how much Amazon has done video as well as potentially your own in-house produced content currently helps and will -- should in the future help reduce churn in Amazon Prime? Thanks.

Tom Szkutak

Thanks for the question. Yeah. It's something we haven't released any of the numbers. It's something that we are tracking very closely. It is something that we believe over time will reduce churn and it's certainly helping today. What we are seeing is great traction. We see a lot of usage of the service.

Customers love it and we think it is very interesting part of Prime offering. And that's why we have been expanding NYC, some of the more recent announcement including some of the stuff included in the earnings release today around original content So, again, it's something that we find very interesting and we are excited about it.

Operator

And we will go next to Ken Sena of Evercore Partners with our next question.

Ken Sena - Evercore Partners

Hi. I was just hoping you can maybe provide a little more color on the unit growth deceleration. And looking back over the last four quarters, it seems like about 500 basis points or so each quarter of deceleration. You had about 200 basis points here, which is an improvement. But anything you could say just to any signs of maturity in some of the business anywhere that deceleration is specifically coming?

Tom Szkutak

No, there is not a lot I can add. I mean I think the 30% book, very strong growth rate. Again it's growing at a faster rate than revenue, revenue at 20%, revenue at local currency growth of 24%, a very strong third-party growth continues to be very strong. Retail growth is strong. So again there is not a lot I can provide you there. But again keep in mind that we are overlapping 49% growth last year Q1, which is certainly little bit of a difficult compare but again fees would be 30% growth rate.

Operator

And our next question today comes from John Blackledge, Cowen & Company.

John Blackledge - Cowen & Company

Just a question on the Amazon advertising platform, given the immense amount of purchase ad you have on Amazon customers, how is that being used as a competitive advantage and maybe you just provide an overall view on the direction of the Amazon ad platform over time?

Tom Szkutak

In terms of the platform itself, we think it's a very sizable, very good long-term opportunity for us. And it's something that we've been working on for some time and we think it's very interesting. One thing you'll notice, on our site we're being obviously very -- making sure the customer experience is great. What we are really trying to do is we are trying to help customers find and discover what they want to buy online. So we're and it's very customer centric but it's also from a business standpoint of very good long-term opportunity with great team that's working on the opportunity. And we're excited about the long term potential of it.

Operator

Moving on to Anthony Diclemente of Barclays.

Anthony Diclemente - Barclays

I am just wondering what you are seeing in terms of the attach rate of your transactional video on demand business versus usage of PrimeInstant Video. I am wondering just if your consumers tend to choose between the two, when they are making the selection or there's one sort of drives the other, does the Prime subscriber have a higher transactional VOD attach rates than non-Prime? So would be helpful to see -- to hear what you're seeing there in terms of usage?

Tom Szkutak

Yeah, I think the thing that can help with this, we see -- of Prime customers, for example, we certainly see adoption of the service in terms of free content but those same customers are purchasing content as well. So there is a good attachment to it which we like. And we see Prime members doing not just within video content but we see them doing a lot of cross-shopping. So it's not surprising we see them do, maybe a customer comes in, and had been traditionally purchasing them pre-Prime, in a few categories, we find that they do a lot more cross-shopping. Same thing with digital content. They use the service, they might start with free content and then they will also continue to purchase paid content. So it's a nice effect that we're seeing, which is why we like Prime so much.

Operator

Up next, we will hear from Youssef Squali of Cantor Fitzgerald.

Youssef Squali - Cantor Fitzgerald

Two quick questions please. Going back to the international, a question, what's going on in the international media to decelerate, I think last year Q1 I think it was up 22%, FX adjusted this quarter was up 7%. Is that all macro or are there any maybe other factors that you can talk about, maybe specific to SKUs or something? And the other is more of a clarification. I know last quarter you gave the unit growth in aggregate versus the unit growth of the retail, just wondering if you could give that to us as well?

Tom Szkutak

In terms of the international media growth, this quarter it was 1% on a dollar basis, 7% on a local currency basis, which you -- in terms of the overall growth rate certainly what you're seeing is digital content as part of that is growing very fast. But it's not as large or as penetrated. Our

ecosystem isn't as developed I would say as it is in the U.S. And so when you compare the two geographies for second that's one of the more meaningful differences that you see between the two as you see that both are growing digital content very fast.

It is just the ecosystem is more build out in North America. But again, certainly we see very positive signs back in the growth we're experiencing in international. It's just on the lower base. So that's began to be helpful there.

In terms of the unit growth, we said that our overall unit growth was 30% for the quarter. Our 3P unit growth I don't have the overall growth rate but it's growing at a faster rate than the total.

Operator

And our next question today will come from Jordan Rohan of Stifel.

Jordan Rohan - Stifel

Yeah. I was hoping you could comment on the market entry and expansion strategy for Amazon in Brazil. There seemed to be tremendous amount of press last year about it and it seems to have died to some degree. I know the company may already be there with Amazon Web Services and some Kindle offerings. But when do you think that might get a little bit broader?

And secondly, there's been some stories recently about an Internet streaming device or box or set-top box, something of those sorts. Can you comment on any new hardware form factors including apps as of some sort of a cell phone or handset that might be coming down the pipe, anything to look forward to in the Kindle family or related? Thanks.

Tom Szkutak

In terms of geographic expansion, there is not a lot I can say specifically about Brazil. We think we are in the right geographies right now. We've expanded into a number of geographies over the past few years. That is certainly something always we look at and you should expect us to expand to additional geographies over time.

In terms of any questions related to our product roadmap, we don't -- we've a longstanding practices of not talking about what we might, or might not do there. But we are certainly excited about the product roadmap that we have for the future and again, we've a longstanding practice of not giving details until closer at launch.

Operator

And ladies and gentlemen, we do have time for one final question today. That question will come from Jason Helfstein of Oppenheimer & Company.

Jason Helfstein - Oppenheimer & Company

Thanks. Can you give us a little more color around customer growth? I mean, that number has been slowing not dramatically, but that is a slowing trend. Are you focused more on higher value customers to drive the business and any color around the quarter would be helpful? Thanks.

Tom Szkutak

We're actually pleased with the growth from a customer standpoint. We've seen very good growth and we continue to -- we have many, many teams across Amazon that are just heads down focused on trying to improve the customer experience and inventing on behalf of customers. So, we couldn't be more pleased with what they are doing, and you see that reflected in our overall growth rate this quarter with revenue up 24% on a local currency basis and units growing at 30%, on top of strong growth quarter last year Q1.

Jason Helfstein - Oppenheimer & Company

Thank you.

Tom Szkutak

Great.

Sean Boyle

Thank you for joining us on a call today and for your questions. The reply will be available on our investor relations' website at least to the end of the call. We appreciate your interest at Amazon.com and look forward to talking with you again next quarter.