

Operator

Thank you for standing by. Good day everyone and welcome to the Amazon.com Q3 2014 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'll be turning the call over to the Director of Investor Relations, Phil Hardin. Please go ahead.

Phil Hardin

Hello, and welcome to our Q3 2014 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, October 23, 2014 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 2013.

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

Tom Szkutak

Thanks, Phil.

I'll begin with comments on our third quarter financial results. Trailing 12-month operating cash flow increased 15% to \$5.71 billion. Trailing 12-month free cash flow increased to \$1.08 billion. Trailing 12-month capital expenditures were \$4.63 billion.

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

Return on invested capital was 6%, up from 3%. 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. The combination of common stock and stock-based awards outstanding was 481 million shares compared with 475 million one year ago.

Worldwide revenue grew 20% to \$20.58 billion or 20% excluding the \$13 million favorable impact from year-over-year changes in foreign exchange.

Media revenue increased to \$5.24 billion, up 4% or 4% excluding exchange. EGM revenue increased to \$13.95 billion, up 26% or 26% excluding foreign exchange. Worldwide EGM increased to 68% of worldwide sales, up from 65%. Worldwide paid unit growth was 21%. Active customer accounts was approximately 260 million. Worldwide active seller accounts were more than 2 million. Seller units represented 42% of paid units.

Now I'll discuss our operating expenses, excluding stock-based compensation. Cost of sales was \$14.63 billion or 71.1% of revenue compared with 72.3%. Fulfillment, marketing, tech and content and G&A combined was \$6.09 billion or 29.6% of sales, up approximately 350 basis points year-over-year. Fulfillment was \$2.55 billion or 12.4% of revenue compared with 11.5%. Tech and content was \$2.22 billion or 10.8% of revenue compared with 9.2%. Marketing was \$961 million or 4.7% of revenue compared with 3.9%.

Now I'll talk about our segment results. And consistent with prior periods, we do not allocate to segments our stock-based compensation or other operating expense line item.

In the North America segment, revenue grew 25% to \$12.87 billion. Media revenue grew 5% to \$2.73 billion. EGM revenue grew 31% to \$8.79 billion, representing 68% of North America revenues, up from 65%. Other revenue grew 40% to \$1.34 billion. North America segment operating income decreased 70% to \$88 million, a 0.7% operating margin.

In the international segment, revenue grew 14% to \$7.71 billion. Excluding the \$21 million year-over-year favorable foreign exchange impact, revenue growth was 13%.

Media revenue grew 4% to \$2.51 billion or 3% excluding foreign exchange and EGM revenue grew 20% to \$5.16 billion or 19% excluding foreign

exchange. EGM now represents 67% of international revenues, up from 64%. International segment operating loss was \$224 million compared to international segment operating loss of \$28 million in the prior period.

Consolidated segment operating loss was \$136 million compared to consolidated segment operating income of \$267 million in the prior period. Consolidated segment operating loss includes charges of approximately \$170 million, primarily related to the Fire phone inventory evaluation and supplier commitment cost.

Unlike CSOI, GAAP operating income or loss includes stock-based compensation expense and other operating expense. GAAP operating loss was \$544 million compared to operating loss of \$25 million in the prior period.

Our income tax benefit was \$205 million, GAAP net loss was \$437 million or \$0.95 per diluted share compared with a net loss of \$41 million and \$0.09 per diluted share.

Turning to the balance sheet, cash and marketable securities decreased \$806 million year-over-year to \$6.88 billion. Inventory increased 21% to \$7.32 billion and inventory turns were 8.9, down from 9.2 turns a year ago, as we expanded selection, improved in-stock levels and introduced new product categories. Accounts payable increased 18% to \$11.81 billion and accounts payable days decreased to 74 from 75 in the prior year.

I'll 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 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 consumer spending. It's not possible to accurately predict demand, and therefore our actual results could differ materially from our guidance.

As we described in more detail in our public filings, issues such as settling intercompany balances and foreign currencies amongst our 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, restructurings or legal settlement, record any further revisions to stock-based compensation estimates and that foreign exchange rates remain approximately where they've been recently.

For Q4 2014, we expect net sales of between \$27.3 billion and \$30.3 billion or growth between 7% and 18%. This guidance anticipates approximately 250 basis points of unfavorable impact from foreign exchange rates. GAAP operating income or loss to be between \$570 million loss and \$430 million income compared to \$510 million of income in the fourth quarter of 2013. This includes approximately \$470 million for stock-based compensation and amortization of intangible assets.

We anticipate consolidated segment operating income or loss, which excludes stock-based compensation expense and other operating expense to be between \$100 million loss and \$900 million in income compared to \$876 million in income in the fourth quarter of 2013.

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 shareowners.

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

Phil Hardin

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

(Operator Instructions) Thank you. Our first question comes from analyst Brian Pitz with Jefferies and Company.

Brian Pitz - Jefferies

Great thanks. Two quick questions. Can you provide any color on the consumer over this year's back-to-school season and how do you view the outlook for the consumer as we head into the holidays?

And then separately you recently closed the acquisition of Twitch last month. Can you help us understand where does Twitch fit into your overall digital content strategy? Thanks.

Tom Szkutak

Sure, in terms of back-to-school, certainly the results are reflected in the Q3 results that you see today. There's a number of different impacts back-to-school has.

One thing I would like to call out, as you look at our North American media growth rates one thing that we are seeing is certainly a shift from a text book standpoint from purchase to rental and so we see a lot more customers renting. So you see that impacting the growth rate a bit the North American media.

But in terms of Q4 as in any Q4, when we look at it, there is a wide range of outcomes. We're giving a wide range of guidance. What we feel good about is we have a team that's been improving customer experience over the past twelve months.

We're very excited to serve customers. We've had a lot of unique selection. We've got inventory closer to the customers. Many, many different things that we're doing on behalf of customers. So we are very excited about the holiday season and look forward to serving customers.

In terms of Twitch, we're very excited to have Twitch as part of our overall team. We've been in video games for quite some time and we think that it's a very creative team.

They're doing some very innovative things on behalf of their customers and our customers and so we're excited to have them, be part of Amazon and look forward to working together with that team.

Brian Pitz - Jefferies

Great. Thanks.

Operator

Thank you. Our next question will come from Carlos Kirjner analyst with Bernstein.

Carlos Kirjner - Bernstein

Thank you for taking my question. Two if I may. International CSOI margin this quarter were the lowest they have been in years, maybe ever, I don't know. We know you have been investing internationally but has something changed fundamentally and if yes, what?

Secondly, I wanted to ask you about vast difference in revenue growth rate between your international and domestic business. What is fundamentally different between the U.S. and your main international markets and is this difference fundamental or temporary? Thank you.

Tom Szkutak

Thank you. Thanks for the question. In terms of the consolidated segment or the segment operating income, excuse me, for international, certainly versus what you'd have seen last quarter some notable changes, one is we're certainly getting ready for the holiday season, so as to get ready for the holiday season.

We are expanding from a capacity standpoint. We do see -- we've gotten great penetration and Fulfilled by Amazon customers. So you'll see that actually our growth rate -- unit growth rate is actually higher than our revenue growth rate and so that's what we've been experiencing so certainly adding capacity from a fulfillment perspective, adding capacity from an infrastructure standpoint. If you look at our overall operating expenses, we are certainly investing and with the slower growth rate you're not seeing as much leverage. We understand that we do have to get leverage over time, but we are investing right now. We're also investing in newer emerging geographies including India and Italy and Spain and continue to invest in China.

And then one other call out, we -- mentioned in my opening remarks there was approximately \$170 million impact related to inventory evaluation and supplier commitment costs, a vast majority of that was in North America, but there was about \$25 million in international just to let you know that that's there.

In terms of the growth rate, it has been softer across a number of geographies. If you look back over the past really four quarters, we've seen a little bit of volatility between the quarters, but it's been softer.

We continue to focus on the inputs and we still think international is a very big opportunity for us in terms of growth. More recently if you look at the growth rate for Q3 and you see the 13% excluding foreign exchange, you may remember on the last call about 90 days ago, I talked about Q2 what had happened was we had seen -- in late Q1 we had seen a ramp up in Japan before the consumption tax increase happened on April 1.

We saw a pretty sizable drop off in Japan growth rates from Q1 to Q2, which brought that down. The only update again is the number of different puts and takes by geographies, but the only other comment I would say is that we really haven't seen Japan growth rates improving since Q2. So that's something that's there.

But in terms of the fundamentals, long term we're very excited about international as well as North America. We think it's a big opportunity. We continue to focus on the inputs. Some of those inputs are certainly on the media side working on the conversion from physical media to digital media.

We continue to work on that in a number of different ways. We continue to add new selection in those geographies and work on the retail basics and so again we're very excited about the opportunity.

Carlos Kirjner - Bernstein

Thank you.

Operator

Thank you. And our next call will come from analyst Scott Devitt with Stifel.

Scott Devitt - Stifel Nicolaus

Hey Tom, thanks. I had a question just broadly. A lot of the capital that's been deployed in terms of planting seeds and new businesses have worked out very well, but given what's happening right now in terms of the deterioration in the margin structure as growth is slowing, I am just wondering and I think a lot of investors have this question as well and in terms of when things don't go as anticipated in some of the bigger projects where there is not a revenue stream like areas maybe like some of the hardware projects and China and other markets, what's the process for determining whether to plough ahead or turn back capital and redeploy in another areas. Thanks.

Tom Szkutak

Thanks for the question Scott. With anything new that we do and obviously we've done -- as you mentioned we've done a lot of new things. There is certainly a wide range of outcome and we certainly understand that. We try to learn from everything that we do as we launch new opportunities and so that's something across things that go great and things that don't go as well as others. We try to learn from that.

And so the way I will describe it is from a looking forward standpoint we still think that we have a lot of opportunities. That said, we need to be very selective about what opportunities we pursue and so that's again the way we're thinking about it and probably not much more I can add to it than that.

Scott Devitt - Stifel Nicolaus

Okay. Thank you.

Tom Szkutak

Sure.

Operator

And we'll continue on to analyst Mark Mahaney with RBC Capital Markets.

Mark Mahaney - RBC Capital Markets

Two questions please. That \$170 million in charges related to the Fire phone, where was that put in the P&L and which are the OpEx lines or was it a COGS?

And then secondly on the media side, you talked about maybe seeing a negative impact or definitely seeing a negative impact from the switch towards owning to renting. Do you think that's a broader trend beyond just text books that affects all media retailers including Amazon? Could that have been -- could that be one of the issues behind the slow media growth in international markets and if so, is there really a solution to that other than your own rental -- your own rental models? Thank you.

Tom Szkutak

Sure. In terms of the first question, the \$170 million, it's predominately in COGS and so it's the very vast majority than COGS and then in terms of the split about 25 million is in international and the remainder is in North America.

In terms of the growth, we certainly are seeing that in text books. We do see another - digital media, we're certainly seeing rentals being part for our portfolio more than we had probably during - certainly with physical, but in terms of some of the recent growth rates, the one that I called out related to book rentals are certainly impacting North American media.

One of the other things that's certainly impacting it too is we did had some things last year Q3 that were overlapping, that were positive in Q3 last year from a demand standpoint. One was certainly in physical books we had very heavy discounting, which helped our growth in Q3 last year. We're overlapping that in Q3 this year.

Mark Mahaney - RBC Capital Markets

Thanks Tom.

Tom Szkutak

Thanks Mark.

Operator

Thank you. We'll now go to analyst Aram Robinson with Wolfe Research.

Aram Robinson - Wolfe Research

Hey there and thanks for taking my question. Hoping we can go back to square one here if you don't mind, can you tell us or remind us what financial measures are important to you guys and which financial measures do you hold yourselves and the Board hold you accountable to because it's a little hard to see any of them making positive progress, so I just would love to get back to basics?

Tom Szkutak

Sure, we're looking at a number of different metrics over a long period of time and certainly where our goal is to maximize free cash flow over the long term, we don't focus on individual margins, but we do focus on the inputs that are going to help drive free cash flow and operating income.

We certainly will look at making sure that we're using our capital wisely so that over time we get good returns on invested capital and we certainly have been in several years now of what I would call an investment mode and because of the opportunities that we had in front of us.

And as I mentioned earlier there is still lots of opportunity in front of us and -- but we know that we have to be very selective about which opportunities we pursue and -- but we're encouraged by the opportunities that we have.

Aram Robinson - Wolfe Research

So cash flow and return on invested capital is where we should keep our attention.

Tom Szkutak

Yes.

Aram Robinson - Wolfe Research

Okay. And are the employees in the recruiting side, is that becoming more difficult as the stocks has [faded] [ph] a little bit and those return characteristics have [faded] [ph], how are you making sure that you're hiring the best people?

Tom Szkutak

We have -- we have processes in place to make sure that we have a very high bar on the hiring that we do, the people that we're hiring are

extraordinarily talented. We're very fortunate to get to work with so many talented people here and we've been fortunate to be able to grow that employment base to work on the opportunities that we have.

Aram Robinson - Wolfe Research

Thank you.

Tom Szkutak

Thank you.

Operator

Thank you. And we'll go to analyst Colin Gillis with BGC Financial.

Colin Gillis - BGC Financial

Great. Thanks for taking my question. So just to get back to that North American media sales, what's the lowest growth rate in over 20 years -- are there -- or 20 quarters, are there other factors beyond the text book shifts and sort of the Q3 strength last year? Are the digital media trends still intact?

Tom Szkutak

In terms of the principal drivers -- it's the two that I mentioned. So it's the text books rentals and also overlapping some of the strong discounting and strong titles that we had in some categories. So it's across a number of categories within media, but those are the two principle drivers.

Colin Gillis - BGC Financial

And you don't see this as a broader shift in that number?

Tom Szkutak

No, we're -- there's still both in terms of North America and international, there is certainly a shift that's going on from physical to digital and that's something that we're spending a lot of time on and trying to improve the experience for customers and we've been able to do that certainly over a period of time and so it's something we'll continue to work on.

Colin Gillis - BGC Financial

Okay. Great. Thank you.

Tom Szkutak

Sure.

Operator

Thank you. And we'll continue on to analyst Ron Josey with JMP Securities.

Ron Josey - JMP Securities

Great. Thanks for taking the question. Two please. If you could update us on this rotation center rollout, are all 15 online, and I would love to know maybe how they've helped bridge the last mile and improve overall speed delivery.

And then the second question, sort of switching gears and just focusing on advertising, I believe a pilot was launched or beta was launched for Amazon's ad network called CPM Ads I think maybe last August. I am wondering if you can provide some commentary there. Thank you.

Tom Szkutak

Sure, in terms of the sort centers, we'll have over 15 sort centers in the U.S. by the end of the year. It's certainly helping us a lot. We have same day delivery in 12 cities. We'll have Sunday delivery in approximately 50% of the population and so we're pleased to do that.

And in terms of the ad network, there is a not a lot I can say there.

Ron Josey - JMP Securities

Okay. Thank you very much.

Tom Szkutak

Sure.

Operator

Thank you. Our next question will come from analyst Aaron Kessler with Raymond James.

Aaron Kessler - Raymond James

Great. Thanks for taking my question. Can you just give us an update maybe on your views on original programming? It looked like Transparents had some good success. Also just from an international standpoint your views or may be the growth in China, India as well, are you seeing any -- signs of any increasing competition in the international, your key international markets today? Thank you.

Tom Szkutak

Sure. In terms of our original content, we're excited about it. We're investing as we talked about. Last quarter we spent approximately \$100 million in the quarter. Keep in mind that that's expensed in the quarter and so that's included in the results that you see in Q3.

We're very excited about it. We have a number of pilots as well as a number of series launched. Transparent you mentioned is one of them. It's gotten very good reviews. The streaming on that series has been great. So we're very excited about it and we think it's an interesting area for customers.

We continue to invest heavily in video content including originals and there is a number of different metrics we're looking at certainly from a prime standpoint, but what we're seeing so far are those customers who are streaming are renewing at considerably higher rates at considerably higher rates at a rate that's already high.

So we like what we see there. When customers come in for new trials and they -- free trials and they engage from a video content standpoint, we see the conversion being higher. So we see that we're adding new prime members as a result of that and when those prime members, when those new prime members become prime members, the other thing we're seeing is they're buying physical product, which is a great impact for us.

We see very similar patterns in terms of how much physical product that they're purchasing from us and so we're still certainly in investment mode there, but we like what we see and we have a long way to go there, but we're concentrating on building great service and we see that customers are rewarding us with engagement on the content, both original and licensed and they're buying more from us on the physical side and becoming prime members when they do and have been doing at higher rates.

So those are the some of the early signs and we will continue to monitor very closely, but we're excited about what we're seeing there.

In terms of some of the international comments and I would say this for not just international, but I would say it for the U.S. as well, one thing that's not new is it's a very competitive environment. We have a lot of competitors both online and offline. That's not anything that's new. We used to operate in that environment.

We've been in that environment for really for 19 years and so -- but we're seeing a lot of competition and again that's not new.

Aaron Kessler - Raymond James

Great. Thank you.

Tom Szkutak

Sure.

Operator

Thank you. Our next question will come from Heath Terry with Goldman Sachs.

Heath Terry - Goldman Sachs

Great. Thanks. Last quarter you mentioned that the AWS business saw a 90% increase in volume. I was wondering if you could give us a sense of what you've seen so far this quarter.

And then in the highlight section of the release, the first six bullet points or so that you have there are all related to the hardware side of the business. If you can just sort of give us now that you have a little bit more time on the hardware side of the business, but behind if you can give us a sense of what you're learning in this category and where you think Amazon's long term position in hardware is ultimately going to be.

Tom Szkutak

In terms of AWS, we're -- we saw a very good growth in Q3 as well. From a usage standpoint it's very similar to Q2, close to 90% and so the team is doing just a fantastic job.

You can see our other revenue in North America went up a little bit sequentially and AWS is certainly the largest piece of that and is the vast majority of it and they're growing at a faster rate than that other line item.

So again the team is doing a fantastic job and not only serving customers, but launching many, many new features and services and you can see some of the detail on that in the Highlight section of our release today. So we're very excited about it.

In terms of devices, I can't speculate what we would do going forward, but we just launched a number of new tablets and e-readers that were excited about and there is some really great price point for customers on the tablet side.

We also launched a kid's tablet which is the first time we've launched. We've launched some new kindles including our premium kindle and it's a terrific product. We think it's the best kindle we've made to date for sure and so

we're very excited about that. And we're excited to have these offerings for customers.

Heath Terry - Goldman Sachs

Great. Thank you.

Operator

Thank you. We'll continue on to analyst Ben Schachter with Macquarie Equities Research.

Ben Schachter - Macquarie

Hi Tom. You mentioned that you need to get leverage at some point. In the last call you also said something similar, but can you help us quantify the timing that in your internal modeling when do you expect to see more meaningful leverage and when you look at your three to five year's outlook, what does your leverage picture look like there and then also can you remind us of what your philosophy of stock buybacks is and what would it take to get you back in the market, thanks?

Tom Szkutak

In terms of leverage, beyond the guidance that we're giving today, there is not a lot of certainly I can give you, but again what I had mentioned earlier is we do have a lot of opportunities, but our job is to be judicious and selective about what opportunities we pursue.

And so that's the way we're thinking about it and I apologize I can't give you any more certainty in terms of timing, but certainly that's the way we're thinking about it.

And in terms of buybacks, we haven't opened buybacks right now. We have authorization to do that. I certainly can't comment on what price points we would or wouldn't do there.

Operator

Thank you. We'll continue on to analyst Justin Post with Merrill Lynch.

Justin Post - Bank of America-Merrill Lynch

Great. Thank you. If you look at the phone impact in Q3, it seems to explain some of the difference versus the Street, but when you look forward to Q4, it looks like you're guiding to about 15% to 16% growth ex FX and again profits maybe below some expectations.

Is the phone having an impact on profits in Q4 as well? And also when you think about the Q4 guidance are there any events or things you want to call out? Are you being especially conservative in Q4 giving recent trends? Anything different this year on holiday? Thank you.

Tom Szkutak

Yes. In terms of the holiday season just and if you look back the last several years, I've been giving wide ranges because it's again a more seasonal quarter, always challenging to predict precisely where we're going to be. So in terms of a dollar range I gave us \$3 billion range last year.

I am giving a \$3 billion range again this year from a revenue perspective again wide range. At the higher end of the range, excluding foreign exchange, it's approximately 21%. So it's a little bit higher than what we saw in Q3 and then you can see we're on the low end of the range.

In terms of -- but in terms of the season itself, we're very excited about it. And in terms of to serve customers, we feel great about the selection that we have added and are continuing to add for the holiday season.

We think from an operations standpoint each year we try to get better and we believe we'll be even better this year than we have had in previous years. And so we are super excited to serve customers.

In terms of the phone, the only other thing that I can comment on is at the end of Q3, we had approximately \$83 million worth of inventory on hand. And so I can't comment on how that would impact guidance or not, but that's the amount of inventory we had on hand at the end of Q3.

Justin Post - Bank of America-Merrill Lynch

Thank you.

Tom Szkutak

Sure.

Operator

Thank you. Our next analyst will be John Blackledge with Cowen & Company.

John Blackledge - Cowen & Company

Great. Thanks. Just a couple of questions. We saw that Amazon Fresh expanded into Brooklyn recently. Just wondering if we can discuss your

decision to expand into New York City and how we should think about timings for expansion into other markets and then if you can update us on the number of fulfillment centers globally and in the year that would be great. Thank you.

Tom Szkutak

Sure, in terms of the number of fulfillment centers it's 13 net for the year and then on as I mentioned earlier in the U.S. we'll have 15 sort centers by the end of more than 14, excuse me, more than 15 sort centers by the end of the year.

In terms of, sorry the other part of the question was on Fresh, the team is doing a great job from a customer experience standpoint. As you can see we're in a few cities. Today, the team is just heads down focused on making sure that experience is great for customers. We continue -- customers like the service.

So we're seeing good pick up there and as you mentioned, we're expanding in the Brooklyn. I can't speculate on what we do beyond the cities that we have launched today, but we're excited about what we're seeing so far there.

Operator

Thank you. Our next question will come from analyst Eric Sheridan with UBS.

Eric Sheridan - UBS

Thanks for taking the question. Tom you guys put thorough a price increase on the prime services here. Was curious what you were seeing in terms of the impact of that price increase on both the rate of adding people into Prime and the ability to control churn inside the Prime subscription base in general.

And as you add additional functionality and layers into Prime like you've done this year through the investments, whether you've thought about maybe put in another price increase through next year. Thanks.

Tom Szkutak

In terms of what we do going forward it certainly wouldn't speculate. We had a price point since our initiation of, excuse me, since the launch of Prime. Its \$79 and so it took us long time and we were very careful with that to increase it to \$99.

But since we've increased to \$99 we've had -- we've had great retention. We're very pleased with the -- the retention we've had from customers. The program is growing very fast. We're very excited about it and so we do think it's really good for customers and it's really good for us and shareowners over the long term.

You're correct in that we're investing in Prime in a number of different ways including video content as I talked about earlier that is certainly the way we'll get a return on that investment. Principally will be customers buying more including and especially physical products.

So again we're very excited about Prime globally.

Operator

Thank you. Our next analyst will be Brian Nowak with SIG.

Brian Nowak - SIG

Thanks for taking my questions. I have two please. The first one, fulfillment ex stock based comp was the highest it's ever been as a percentage of gross profit in the third quarter, can you just talk about the drivers of that? Is that for rotations centers or international growth, what's driving that?

And then as we think about this rotation centers, what's the impact of those over the next few quarters to fulfillment? Are they do they take a while to kind of get the inefficiencies out of the system like a standard DC would?

Tom Szkutak

Yes, in terms of fulfillment cost, you're right. Again we're adding 13 net fulfillment centers where we added -- we'll have over 15 sort centers at the end of the year. certainly one of the drivers for that is certainly the growth that we are experiencing, but in addition to that, what we're seeing is the FBA adoption continues to get better and if we get further penetrated with sellers adopting full by Amazon, we think that's really good for sellers and for us and for customers over the long term.

And what you're seeing is we're several years ago in terms of performance center planning we were adding less of them and it was much closer to the holiday season. With the sheer amount of capacity that we're adding, you're seeing more of that come in even before Q4.

So you're seeing that impacting us earlier and the benefit of coming in earlier is we get to serve customer and get up to the productivity rates that

we want to, to serve customers in Q4, by having that capacity in a bit earlier than in the past.

So you've seen that trend happen over the past few years with that coming in earlier than certainly historically we've been able to do.

Brian Nowak - SIG

Okay. Great. Thanks.

Operator

Thank you. Our next analyst will be Matt Nemer with Wells Fargo.

Matt Nemer - Wells Fargo

Thanks so much for taking my questions. First Prime launched a referral fee recently and I am wondering if we should take that as any indication that the membership growth has slowed or you're seeing some higher churn and how does that referral fee get accounted for.

And then secondly, Target launched free shipping with no hurdle for the holidays versus your \$35 hurdle, I am just wondering what your willingness is to leave that competitive gap during the holidays, thanks.

Tom Szkutak

Yes, can't comment from a competitive standpoint what we might or might do there, but in terms of the Prime referral fee, no, you should not read into that that Prime isn't growing well and in fact just the opposite.

We're seeing great growth and we like the fact that enabling customers because they like Prime to be able to refer others we think is great for us and so I can't actually maybe offline you can follow-up with Phil or Dave on the accounting. Top of my head, I can't remember how that's working, but I know they will be able to answer it for you.

Matt Nemer - Wells Fargo

Okay. Thanks so much.

Operator

Thank you. And ladies and gentlemen, our final question will come from Colin Sebastian with Robert W. Baird.

Colin Sebastian - Robert W. Baird

Great. Thanks. Good afternoon. A couple of follow-ups. First off in terms of the Q4 revenue guide, are you giving any consideration to that forecast to some of the shipping issues that happened last holiday and the ability of your shipping partners to manage your growth.

And then secondly on paid units, can you provide a splits or color between physical and digital unit growth. Thanks.

Tom Szkutak

In terms of -- in terms of the guidance it reflects all of the assumptions that we think could happen for the quarter. So again it's a wide range to speak specifically to some of the issues last year. The team again -- we continue trying to learn from everything that we do and the team has done a great job learning from our experiences, coming out of Q4 last year as we do every year and are excited to serve customers.

In terms of the unit growth, there is not I can add in terms of split other than the overall -- other than the overall growth rate, but we are -- we are pleased with certainly we're seeing good customer growth, sellers are -- we're doing we think a great job for sellers. We continue to add a lot of unique selection throughout the year in terms of and we have customers.

We see FBA four sellers getting further, further penetrated. We've launched some interest in products for our customers. We think our web services team is doing a great job.

We realize that we have a lot of opportunities, but we need to be selective on which opportunities we pursue and I think beyond that, we're just overall excited and again ready for the holiday season.

So anyway thanks everybody for calling in today.

Phil Hardin

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

Operator

And again, ladies and gentlemen, that does conclude today's conference. Thank you all again for your participation. You may now disconnect.