10-Q 1 e10-q.txt FORM 10-Q 1

UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 --------------- FORM 10-Q --------------- (MARK ONE) [X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2000 OR [ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ____________ TO ____________ . COMMISSION FILE NO. 000-22513 AMAZON.COM, INC. (EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER) DELAWARE 91-1646860 (STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER INCORPORATION OR ORGANIZATION) IDENTIFICATION NO.) 1200 12TH AVENUE SOUTH, SUITE 1200, SEATTLE, WASHINGTON 98144-2734 (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, ZIP CODE) (206) 266-1000 (REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE) --------------- Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ] 355,864,012 shares of $0.01 par value common stock outstanding as of July 20, 2000

2 AMAZON.COM, INC. FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2000 INDEX

2 3 PART I. FINANCIAL INFORMATION ITEM 1. FINANCIAL STATEMENTS AMAZON.COM, INC. BALANCE SHEETS (IN THOUSANDS, EXCEPT PER SHARE DATA)

JUNE 30, DECEMBER 31, 2000 1999 ------------ ------------- (unaudited) ~~ASSETS Current assets: Cash and cash equivalents .... $ 720,377 $ 133,309 Marketable securities .... 187,244 572,879 Inventories .... 172,360 220,646 Prepaid expenses and other current assets .... 86,659 85,344 ----------- ----------- Total current assets .... 1,166,640 1,012,178 Fixed assets, net .... 344,042 317,613 Goodwill, net ....~~

~~441,240 534,699 Other intangibles, net .... 155,538 195,445 Investments in equity-method investees .... 211,715 226,727 Other investments .... 88,261 144,735 Other assets .... 53,294 40,154 ----------- ----------- Total assets .... $ 2,460,730 $ 2,471,551 =========== ===========~~

~~LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) Current liabilities: Accounts payable .... $ 286,239 $ 463,026 Accrued expenses and other current liabilities .... 146,874 181,909 Unearned revenue .... 115,566 54,790 Interest payable .... 41,213 24,888 Current portion of long-term debt and other .... 17,731 14,322 ----------- ----------- Total current liabilities .... 607,623 738,935 Long-term debt .... 2,131,531 1,466,338 Commitments and contingencies Stockholders' equity (deficit): Preferred stock, $0.01 par value: Authorized shares -- 500,000 Issued and outstanding shares -- none .... -- -- Common stock, $0.01 par value: Authorized shares -- 5,000,000 Issued and outstanding shares -- 355,400 and 345,155 shares at June 30, 2000 and December 31, 1999, respectively .... 3,554 3,452 Additional paid-in capital .... 1,335,733 1,194,369 Stock-based compensation .... (25,410) (47,806) Accumulated other comprehensive loss .... (84,664) (1,709) Accumulated deficit .... (1,507,637) (882,028) ----------- ----------- Total stockholders' equity (deficit) ....~~

~~(278,424) 266,278~~ ~~----------- --~~
~~--------- Total liabilities and stockholders' equity (deficit) .. $ 2,460,730 $ 2,471,551~~
~~=========== ===========~~

See accompanying notes to financial statements. 3 4 AMAZON.COM, INC. STATEMENTS OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE DATA) (UNAUDITED)

THREE MONTHS ENDED SIX MONTHS ENDED JUNE 30, JUNE 30, -- ------------------------ --- -------------------- --------- 2000 1999 2000 1999 ----------- ----------- ----------- ----------- ~~Net sales~~ ~~.................................. $ 577,876 $ 314,377 $ 1,151,765 $ 608,019~~ ~~Cost of sales .... 441,812 246,846 887,567 475,696 ----- ------ ---------- ----- ------ ----------~~ ~~Gross profit .... 136,064 67,531 264,198 132,323~~ ~~Operating expenses: Marketing, sales and fulfillment .... 129,813 86,165 269,924 146,883~~ ~~Technology and content .... 67,132 34,149 128,376 57,552~~ ~~General and administrative .... 28,468 14,469 54,513 25,712~~ ~~Stock-based compensation .... 8,166 4,669 21,818 4,780~~ ~~Amortization of goodwill and other intangibles .... 80,413 37,150 163,368 58,050~~ ~~Merger, acquisition and investment- related costs .... 2,449 3,809 4,468 4,208 ----------- ----- ------ ---------- ----- ------~~ ~~Total operating expenses .... 316,441 180,411~~

~~642,467 297,185 ----------- ----------- ----------- ----------- Loss from operations .... (180,377) (112,880) (378,269) (164,862) Interest income .... 10,314 12,860 20,440 23,780 Interest expense .... (33,397) (28,320) (61,018) (44,954) Other expense, net .... (3,272) (74) (8,046) (122) ----------- ----------- ----------- ----------- Net interest expense and other .... (26,355) (15,534) (48,624) (21,296) ----------- ----------- ----------- ----------- Loss before equity in losses of equity- method investees .... (206,732) (128,414) (426,893) (186,158) Equity in losses of equity-method investees . (110,452) (9,594) (198,716) (13,517) ----------- ----------- ----------- ----------- Net loss .... $ (317,184) $ (138,008) $ (625,609) $ (199,675)~~

~~=========== =========== =========== ===========~~

~~Basic and diluted loss per share .... $ (0.91) $ (0.43) $ (1.80) $ (0.63)~~

~~=========== =========== =========== ===========~~

~~Shares used in computation of basic and diluted loss per share .... 349,886 322,340 346,680 318,106~~

~~===========~~

See accompanying notes to financial statements. 4 5 AMAZON.COM, INC. STATEMENTS OF CASH FLOWS (IN THOUSANDS) (UNAUDITED)

SIX MONTHS ENDED JUNE 30, ----------------------------- 2000 1999 ----------- -----------

~~CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD .... $ 133,309 $ 71,583 OPERATING ACTIVITIES: Net loss .... (625,609) (199,675) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation and amortization of fixed assets .... 38,862 13,325 Amortization of deferred stock-based compensation .... 21,818 4,780 Equity in losses of equity-method investees .... 198,716 13,517 Amortization of goodwill and other intangibles .... 163,368 58,050 Non-cash merger, acquisition, and investment-related costs .... 4,468 4,208 Amortization of previously unearned revenue .... (37,266) -- (Gain) loss on sale of marketable securities .... (952) 7,440 Non-cash interest expense and other .... (4,217) 20,526 Changes in operating assets and liabilities: Inventories .... 48,286 (29,886) Prepaid expenses and other current assets .... 6,738 (31,513) Accounts payable .... (176,787) 51,539 Accrued expenses and other current liabilities .... (37,995) 16,931 Unearned revenue .... 203 -- Interest payable .... 9,654 23,950 ----------- ----------- Net cash used in operating activities .... (390,713) (46,808) INVESTING ACTIVITIES: Sales and maturities of marketable securities .... 449,294 3,096,250 Purchases of marketable securities .... (50,786) (3,803,494) Purchases of fixed assets .... (55,479)~~

~~(111,097) Investments in equity-method investees and other investments .... (56,082) (107,362) ----------- ----------- Net cash provided by (used in) investing activities . 286,947 (925,703) FINANCING ACTIVITIES: Proceeds from exercise of stock options .... 35,153 21,626 Proceeds from long-term debt .... 680,999 1,250,000 Repayment of long-term debt .... (9,220) (182,479) Financing costs .... (16,122) (34,937) ----------- ----------- Net cash provided by financing activities .... 690,810 1,054,210 Effect of exchange rate changes .... 24 137 ----------- ----------- Net increase in cash and cash equivalents .... 587,068 81,836 ----------- ----------- CASH AND CASH EQUIVALENTS AT END OF PERIOD .... $ 720,377 $ 153,419 =========== =========== SUPPLEMENTAL CASH FLOW INFORMATION: Fixed assets acquired under capital leases .... $ 4,346 $ 22,637 Fixed assets acquired under financing agreements .... 4,844 5,608 Stock issued in connection with business acquisitions .... 30,000 617,007 Equity securities for unearned Amazon Commerce Network services .... 97,839 --~~

See accompanying notes to financial statements. 5 6 AMAZON.COM, INC. NOTES TO FINANCIAL STATEMENTS (UNAUDITED) NOTE 1 -- ACCOUNTING POLICIES Unaudited Interim Financial Information The accompanying financial statements have been prepared by Amazon.com, Inc. ("Amazon.com" or the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These financial statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary for a fair presentation of the balance sheets, operating results, and cash flows for the periods presented. Operating results for the three-month and six-month periods ended June 30, 2000 are not necessarily indicative of the results that may be expected for the year ending December 31, 2000 due to seasonal and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted in accordance with the rules and regulations of the SEC. These financial statements should be read in conjunction with the audited financial statements, and accompanying notes, included in the Company's Annual Report on Form 10-K for the year ended December 31, 1999. Certain prior period amounts have been reclassified to conform to the current period presentation. Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Cash and Cash Equivalents Effective April 1, 2000, the Company changed its policy for determining which investments are treated as cash equivalents. Effective April 1, 2000, the Company now classifies all highly liquid instruments with an original maturity of three months or less as cash equivalents. Prior to April 1, 2000, such investments were included in marketable securities. The Company believes this change is preferable because it results in a presentation that is consistent with practice in the Company's industry and because it results in a better reflection of the Company's liquidity. The balance sheet as of December 31, 1999 and the statements of cash flows for the six-month periods ended June 30, 2000 and 1999 presented in this Form 10-Q have been restated to reflect this change. Comprehensive Loss Comprehensive loss is comprised of net loss, unrealized gains and losses on marketable securities and other available-for-sale investments, and foreign currency translation adjustments. Comprehensive loss was $355.5 million and $143.0 million for the three-month periods ended June 30, 2000 and 1999, respectively. Comprehensive loss was $708.6 million and $210.9 million for the six-month periods ended June 30, 2000 and 1999, respectively. Loss per Share The number of shares used in calculating loss per share for the three-month periods ended June 30, 2000 and 1999 was reduced by 3.2 million and 5.6 million shares, and the number of shares used in calculating loss per share for the six-month periods ended June 30, 2000 and 1999 was reduced by 3.7 million and 7.2 million shares, respectively. Such reductions reflect the weighted average number of outstanding shares subject to repurchase. Stock options are antidilutive and accordingly excluded from diluted loss per share. Recent Accounting Pronouncements In March 2000, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board reached a consensus on EITF Issue 00-2, "Accounting for Web Site Development Costs." This consensus provides guidance on what types of costs incurred to develop Web sites should be capitalized or expensed. The consensus is effective for Web site development costs incurred for fiscal 6 7 quarters beginning after June 30, 2000. The Company does not expect the adoption of this consensus to have a material impact on its financial position or results of operations. In March 2000, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 44, "Accounting for Certain Transactions Involving Stock Compensation." FIN 44 clarifies the application of Accounting Principles Board Opinion No. 25 for certain issues relating to stock compensation. FIN 44 is effective July 1, 2000, but certain conclusions in it cover specific events that occur after either December 15, 1998, or January 12, 2000. To the extent that FIN 44 covers events occurring during the period after December 15, 1998, or January 12, 2000, but before the effective date of July 1, 2000, the effects of applying FIN 44 are recognized on a prospective basis from July 1, 2000. The Company does not expect FIN 44 to have a material effect on its financial position or results of operations. In May 2000, the EITF reached a consensus on EITF Issue 00-14, "Accounting for Certain Sales Incentives." This consensus provides guidance on the recognition, measurement, and income statement classification for sales incentives offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. This consensus must be adopted no later than October 1, 2000. The Company does not expect the adoption of this consensus to have a material impact on its financial position or results of operations. In July 2000, the EITF reached a consensus on EITF Issue 00-10, "Accounting for Shipping and Handling Fees and Costs." This consensus requires that all amounts billed to a customer in a sale transaction related to shipping and handling, if any, represent revenue and should be classified as revenue. The Company already classifies shipping charges to customers as revenue. The EITF did not reach a consensus with respect to the classification of costs related to shipping and handling incurred by the seller. The Company classifies inbound and outbound shipping costs and the cost of tangible supplies used to package product for shipment to customers as cost of sales. The Company does not currently impose separate handling charges on customers and classifies costs incurred in operating and staffing distribution and customer service centers (including costs attributable to receiving, inspecting and warehousing inventories; picking, packaging and preparing customers' orders for shipment; and responding to inquiries from customers) and credit card fees as marketing, sales and fulfillment expenses. NOTE 2 -- MARKETABLE SECURITIES Marketable securities available for sale, at fair value, consist of the following:

	JUNE 30, 2000	DECEMBER 31, 1999
	(IN THOUSANDS)	
Asset-backed and agency securities	$ 94,462	$247,667
Commercial paper and short-term obligations	16,813	57,210
Treasury notes and bonds	60,510	164,158
Corporate notes and bonds	--	103,844
Equity securities	15,459	--
Total marketable securities	$187,244	$572,879

The Company's marketable securities consist primarily of high quality short- to intermediate-term fixed income securities and equity securities. At June 30, 2000 and December 31, 1999, the cost (amortized cost in the case of debt securities) of the Company's marketable securities was $182.7 million and $601.4 million, respectively. NOTE 3 -- BUSINESS COMBINATIONS In May 2000, the Company made a final payment for its May 1999 acquisition of e-Niche Incorporated (Exchange.com) in the form of common stock of the Company. This payment was made pursuant to the terms of the original agreement and resulted in an increase in goodwill of $30 million related to the Exchange.com acquisition. This additional goodwill was recorded during the three-month period ended June 30, 2000 and will be amortized over a 2-year period. NOTE 4 -- INVESTMENTS IN EQUITY-METHOD INVESTEES 7 8 The Company holds certain investments accounted for under the equity method. The Company accounts for an investment under the equity method if the investment gives the Company the ability to exercise significant influence, but not control, over an investee. Significant influence is generally deemed to exist if the Company has an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's Board of Directors and the impact of commercial arrangements, are considered in determining whether the equity method of accounting is appropriate. The Company records its equity in the income or losses of these investees generally one month in arrears for private companies and one quarter in arrears for public companies. In June 2000, one of the Company's equity-method investees, HomeGrocer.com, Inc. (HomeGrocer), agreed to an acquisition of all of its outstanding common stock by Webvan Group, Inc. Upon closing of this transaction, the Company will no longer account for its investment in HomeGrocer under the equity method as its investment will not give it the ability to exercise significant influence over the combined entity. As a result, the Company will record a gain or loss representing the difference between the fair value and the recorded book value of the investment upon closing of the transaction. As of June 30, 2000, the book value of the Company's investment in HomeGrocer averaged $1.89 per share and the Company owned 27,733,990 shares of HomeGrocer common stock. The Company expects to record additional equity-method losses in HomeGrocer prior to closing of the transaction. The Company has agreed to certain restrictions on sale of the Webvan Group, Inc. common stock it will receive upon closing of the transaction. NOTE 5 -- OTHER INVESTMENTS At June 30, 2000, Other Investments included $26.6 million of investments accounted for under the cost method and $61.7 million of investments in equity securities with ready markets that are recorded at fair value and classified as available-for-sale securities pursuant to Statement of Financial Accounting Standards (SFAS) No. 115. The cost of such noncurrent available-for-sale equity securities at June 30, 2000 was $151.3 million. NOTE 6 -- UNEARNED REVENUE AND RELATED PARTY TRANSACTIONS Unearned revenue is recorded for the fair value of services to be performed in future periods for Amazon Commerce Network (ACN) partners. ACN partners are companies with which the Company has entered into strategic relationships that have generally consisted of the Company making a minority investment in the companies and entering into commercial agreements that involve the sale of products and services by these companies on co-branded sections of the Amazon Web site. The fair value of services provided by the Company to these partners is measured by the consideration paid to the Company by these ACN partners, and has consisted of cash, equity securities of ACN partners or a combination of the two. The Company holds equity securities of most of its ACN partners, some of which are accounted for under the equity method. Fair value of securities is determined based upon the market value, subject to appropriate adjustments for significant restrictions on marketability, at the date the agreement is consummated for ACN partners that are public companies and by an estimate of fair value, based on the use of independent third-party appraisals, for ACN partners that are private companies. In March 2000, the EITF reached a consensus on EITF Issue 00-8, "Accounting by a Grantee for an Equity Instrument to be Received in Conjunction with Providing Goods or Services." This consensus indicates that the grantee should measure the fair value of equity instruments received in conjunction with providing goods or services using the stock price and other measurement assumptions as of the earlier of either (a) the date the parties come to a mutual understanding of the terms of the equity-based compensation arrangement and commitment for performance by the grantee to earn the equity instruments is reached, or (b) the date at which the grantee's performance necessary to earn the equity instruments is complete. The consensus applies to new grants or modifications of existing grants that occur after March 16, 2000. The consensus has not affected the Company's accounting through June 30, 2000 for any of the past transactions in which the Company received an equity instrument in conjunction with providing services. To the extent that previously received equity securities are subsequently modified, these or new equity securities received are subject to vesting or forfeiture provisions and/or no performance commitment exists upon signing of the agreements, as defined in EITF 00-8, the amount of revenue recorded by the Company for ACN transactions during each period will fluctuate based on the then-current fair value of any equity securities. Unearned revenue is recognized over the period in which the service for which consideration has been received is performed (generally one to three years). During the three months and six months ended June 30, 2000, the Company recorded $24.3 million and $44.2 million, respectively, of revenue from ACN partners. For the three months ended June 30, 2000, this revenue was comprised of $4.2 million of cash, $19.2 million of equity securities of public companies and $0.9 million of equity securities of private companies. 8 9 For the six months ended June 30, 2000, this revenue was comprised of $7.0 million of cash, $33.5 million of equity securities of public companies and $3.7 million of equity securities of private companies. The Company has recently entered into amendments and negotiations to restructure its agreements with certain ACN partners and has accepted or has been asked to accept lower future cash payments, revisions to the related term of the agreements, or both. The Company has adjusted the amortization of previously unearned revenue to reflect these modifications. As a result, during the three months ended June 30, 2000, revenue recognized from certain ACN agreements was reduced by a total of $2.9 million. The Company accounts for several of its investments in ACN partners using the equity method. During the three months and six months ended June 30, 2000, the Company recorded $109.9 million and $197.8 million of equity-method losses for investments in ACN partners. NOTE 7 -- LONG-TERM DEBT On February 16, 2000, the Company completed an offering of E690,000,000 ($656,397,000 as of June 30, 2000) of 6.875% Convertible Subordinated Notes due 2010, also known as PEACS. The PEACS are convertible into the Company's common stock at an initial conversion price of E104.947 per share. Interest on the PEACS is payable annually in arrears in February of each year, commencing in February 2001. The PEACS are unsecured and are subordinated to all of the Company's existing and future senior indebtedness. The PEACS rank equally with the Company's outstanding 4 3/4% Convertible Subordinated Notes due 2009 (the "Convertible Notes"). The conversion price for the PEACS will be reset on February 16, 2001 and February 16, 2002, but in no event will the conversion price be reset lower than E84.883 per share. Subject to certain conditions, the PEACS may be redeemed at the Company's option on or after February 20, 2003, in whole or in part, at the redemption price of E1,000 per note, plus accrued and unpaid interest. NOTE 8 -- STOCK-BASED COMPENSATION The following table shows the amounts of stock-based compensation, arising primarily from acquisitions accounted for under the purchase method, that would have been recorded under the following income statement categories had stock-based compensation not been separately stated in the Statements of Operations:

THREE MONTHS ENDED SIX MONTHS ENDED JUNE 30, JUNE 30, ---------------------- ----------------------- 2000 1999 2000 1999 -------- -------- -------- -------- (IN THOUSANDS) (IN THOUSANDS) ~~Marketing, sales and fulfillment . $ (1,591) $ 81 $ (1,260) $ 178 Technology and content .... 9,331 4,386 22,160 4,462 General and administrative .... 426 202 918 140 -------- -------- -------- -------- $ 8,166 $ 4,669 $ 21,818 $ 4,780~~

NOTE 9 -- COMMITMENTS AND CONTINGENCIES Legal Proceedings During the first quarter of 2000, Supnick v. Amazon.com and Alexa Internet and four similar class action complaints were filed against the Company and its wholly owned subsidiary, Alexa Internet. The complaints, which have been consolidated in the United States District Court for the Western District of Washington, allege that Alexa Internet's tracking and storage of Internet Web usage paths violates federal and state statutes prohibiting computer fraud, unfair competition, and unauthorized interception of private electronic communications, as well as common law proscriptions against trespass and invasion of privacy. The complaints seek actual, statutory and punitive damages, as well as restitution, on behalf of all users of Alexa Internet's Web navigation service, as well as injunctive relief prohibiting Alexa Internet from tracking and storing such information or disclosing it to third parties. Although the Company disputes the allegations of wrongdoing in these complaints, there can be no assurance that the Company will prevail in these lawsuits. In addition, the Federal Trade Commission has requested information and documents regarding Alexa Internet's practices and has opened a formal investigative file in connection with its inquiry. The Commission is seeking to determine whether the Company has engaged in unfair or deceptive acts in connection with the advertisement and operation of certain services provided by Alexa. The Company is cooperating voluntarily with the Commission's investigation. 9 10 Depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect the Company's business, future results of operations or cash flows in a particular period. From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights, patents and other intellectual property rights. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on its business, prospects, financial condition or operating results. NOTE 10 -- SEGMENT INFORMATION Information on reportable segments and a reconciliation to net income is as follows:

US BOOKS, EARLY-STAGE MUSIC AND BUSINESSES DVD/VIDEO INTERNATIONAL AND OTHER

CONSOLIDATED - ---------- ---------- ---------- ----------
(IN THOUSANDS) THREE MONTHS ENDED JUNE 30, 2000: Net sales .... $ 385,275 $ 73,393 $ 119,208 $ 577,876 Gross profit .... 86,862 16,286 32,916 136,064 Segment profit (loss) .... 10,056 (34,503) (64,902) (89,349) Other operating expenses .... -- -- -- (91,028) Net interest expense and other .... -- -- -- (26,355) Equity in losses of equity-method Investees .... -- -- -- (110,452) ----------- Net loss .... -- -- -- $ (317,184) ==========
THREE MONTHS ENDED JUNE 30, 1999: Net sales .... 279,593 31,345 3,439 $ 314,377 Gross profit (loss) .... 61,680 6,575 (724) 67,531 Segment loss .... (11,147) (16,034) (40,071) (67,252) Other operating expenses .... -- -- -- (45,628) Net interest expense and other .... -- -- -- (15,534) Equity in losses of equity-method Investees .... -- -- -- (9,594) ----------- Net loss .... -- -- -- $ (138,008) ========== SIX MONTHS ENDED JUNE 30, 2000: Net

~~sales .... 786,689 148,525 216,551 $ 1,151,765 Gross profit .... 169,716 32,323 62,159 264,198 Segment profit (loss) .... 7,630 (61,949) (134,296) (188,615) Other operating expenses .... -- -- -- (189,654) Net interest expense and other .... -- -- -- (48,624) Equity in losses of equity-method Investees .... -- -- -- (198,716) ----------- Net loss .... -- -- -- $ (625,609) =========== SIX MONTHS ENDED JUNE 30, 1999: Net sales .... 547,114 57,064 3,841 $ 608,019 Gross profit (loss) .... 120,946 11,732 (355) 132,323 Segment loss .... (14,264) (30,287) (53,273) (97,824) Other operating expenses .... -- -- -- (67,038) Net interest expense and other .... -- -- -- (21,296) Equity in losses of equity-method investees .... -- -- -- (13,517) ----------- Net loss .... -- -- -- $ (199,675) ===========~~

Revenue and gross profit of $24.3 million and $23.6 million, respectively, was generated on ACN services for the three months ended June 30, 2000. Revenue and gross profit of $44.2 million and $43.1 million, respectively, was generated on ACN services for the six months ended June 30, 2000. Such amounts are included within the results of the Early-Stage Businesses and Other segment. There was no revenue or gross profit on ACN services during the three months or six months ended June 30, 1999. 10 11 The measure of profit or loss used for each reportable segment is income (loss) from operations before other operating expenses, including stock-based compensation, amortization of goodwill and other intangibles, and merger, acquisition and investment-related costs. ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS The following "Management's Discussion and Analysis of Financial Condition and Results of Operations" includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, such as forward-looking statements regarding expectations of future sales, pro forma operating loss and cash balances, the decrease in fulfillment costs as a percentage of sales, the sufficiency of the Company's cash and marketable securities balances to meet our cash needs over the next twelve months, future profitability of the US Books, Music and DVD/video segment, positive cash flow from operations and improvement in operating loss and sales, all of which are inherently difficult to predict. All statements other than statements of historical fact made in this Quarterly Report on Form 10-Q are forward looking. We generally use words such as "anticipates," "believes," "expects," "future" and "intends" and similar expressions to identify forward-looking statements. Forward-looking statements reflect management's current expectations and are inherently uncertain. The Company's actual results may differ significantly from management's expectations for a variety of reasons, including the rate of growth of the Internet and online commerce, the amount that the Company invests in new business opportunities and the timing of those investments, customer spending patterns, the mix of products sold to customers, the mix of revenues derived from product sales as compared to services, the magnitude of losses arising from investments accounted for under the equity method, the degree to which the Company enters into ACN and other strategic transactions, fluctuations in the value of securities and non-cash payments Amazon.com receives in such transactions, risks of inventory management, and risks of distribution and fulfillment throughput and productivity. Other risks and uncertainties include Amazon.com's limited operating history, anticipated losses, potential fluctuations in quarterly operating results, seasonality, consumer trends, competition, risks associated with distribution center expansion, adverse consequences arising from system interruptions, risks associated with management of potential growth, risks related to auction and zShops services, risks related to fraud and Amazon.com Payments, and risks of new business areas, international expansion, business combinations, and strategic alliances. These risks and uncertainties, as well as other risks and uncertainties that could cause the Company's actual results to differ significantly from management's expectations, are described in greater detail in the section entitled "Business -- Additional Factors That May Affect Future Results," which, along with the following discussion, describes some, but not all, of the factors that could cause actual results to differ significantly from management's expectations. OVERVIEW Amazon.com, Inc. is the world's leading online merchandiser. We have served over 22.5 million customer accounts in over 150 countries. We directly offer for sale millions of distinct items in categories such as books, music, DVDs, videos, toys, electronics, software, video games, tools and hardware, lawn and patio products and kitchen products. Our customers can find and discover over 18 million new and used items and purchase them through a variety of methods, including directly from our retail store, through our zShops and Amazon Commerce Network merchants or by participating in auctions at Amazon Auctions or sothebys.amazon.com. In addition to our US Web site, we currently have two internationally focused Web sites located at www.amazon.co.uk and www.amazon.de. We offer our customers a superior shopping experience by providing high value through selection, convenience, ease of use, low prices, product information and an intense focus on customer service. We are a proven technology leader, having developed electronic commerce innovations such as 1-Click technology, personalized shopping services, easy-to-use search and browse features, secure payment protections and wireless access to our stores. We now operate ten distribution centers worldwide comprising approximately five million square feet of warehouse and distribution space, which allows us control over the distribution process and facilitates our ability to deliver merchandise to customers on a reliable and timely basis. Amazon.com was incorporated in 1994 in the state of Washington and reincorporated in 1996 in Delaware. The Company's principal corporate offices are located in Seattle, Washington. Amazon.com completed its initial public offering in May 1997, and its common stock is listed on the Nasdaq National Market under the symbol "AMZN." As used herein, "Amazon.com," "Amazon," "we," "our," "us" and "the Company" includes Amazon.com, Inc. and its consolidated subsidiaries, unless the context requires otherwise. Through our Amazon Commerce Network (ACN), we have recently entered into a number of strategic relationships with selected e-commerce companies. These relationships have generally consisted of our making a minority investment in the companies and the entry into commercial agreements that involve the sale of products and services by these companies on co-branded sections of the 11 12 Amazon Web site. Under these commercial agreements, we received equity securities in our ACN partners with a fair value of $97.8 million, net of cash paid, during the six months ended June 30, 2000 in return for services to be provided by us in the future and recorded such amounts as unearned revenue. We determined fair value of the equity securities at the time these commercial agreements were entered into by the quoted market prices, appropriately considering significant restrictions on marketability, for the public companies, and by independent, third-party valuations for the private companies. Such unearned revenue and any additional proceeds to be received under the arrangements will be recognized in revenue as we provide the related services over the term of the arrangement (generally over the next one to three years). We have recently entered into amendments and negotiations to restructure our agreements with certain ACN partners. We have accepted or have been asked to accept lower future cash payments, revisions to the related term of the agreements, or both. To the extent lower future cash payments in future years resulted from these modifications, the amount recorded as unearned revenue is being recognized as revenue over a longer period of time than contemplated under the terms of the original agreements. See Note 6 of Notes to Financial Statements. RESULTS OF OPERATIONS

THREE MONTHS ENDED SIX MONTHS ENDED JUNE 30, JUNE 30, --------------------------- ---------------- ----------- 2000 1999 % CHANGE 2000 1999 % CHANGE ----------- ----------- ----------- ----------- ----------- ----------- (IN THOUSANDS, EXCEPT GROSS

(IN THOUSANDS, EXCEPT GROSS MARGIN) MARGIN) ~~Net sales .... $ 577,876 $ 314,377 84% $ 1,151,765 $ 608,019 89% Gross profit .... 136,064 67,531 101% 264,198 132,323 100% Gross margin .... 23.5% 21.5% 9% 22.9% 21.8% 5% Marketing, sales and fulfillment................... 129,813 86,165 51% 269,924 146,883 84% Technology and content .... 67,132 34,149 97% 128,376 57,552 123% General and administrative ...... 28,468 14,469 97% 54,513 25,712 112% Stock-based compensation .... 8,166 4,669 75% 21,818 4,780 356% Amortization of goodwill and other intangibles .... 80,413 37,150 116% 163,368 58,050 181% Loss from operations .... (180,377) (112,880) 60% (378,269) (164,862) 129% Interest income .... 10,314 12,860 (20)% 20,440 23,780 (14)% Interest expense .... (33,397) (28,320) 18% (61,018) (44,954) 36% Other expense, net .... (3,272) (74) 4,322% (8,046) (122) 6,495% Equity in losses of equity-method investees .... (110,452) (9,594) 1,051% (198,716)~~

~~(13,517) 1,370%~~

Net Sales Net sales includes the selling price of products sold by us, less returns and promotional gift certificates, and also includes outbound shipping charges charged to our customers. Shipping revenue was $73.5 million and $49.0 million for the three-month periods ended June 30, 2000 and 1999, and $148.1 million and $93.1 million for the six-month periods ended June 30, 2000 and 1999. Net sales also includes ACN revenues of $24.3 million and $44.2 million for the three months and six months ended June 30, 2000, as well as commissions from auctions and zShops transactions. For the three months ended June 30, 2000, ACN revenue was comprised of $4.2 million of cash, $19.2 million of equity securities of public companies and $0.9 million of equity securities of private companies. For the six months ended June 30, 2000, ACN revenue was comprised of $7.0 million of cash, $33.5 million of equity securities of public companies and $3.7 million of equity securities of private companies. Growth in net sales for the six-month period is primarily related to an increase in units sold due to the growth of the Company's customer base, repeat purchases from existing customers, the introduction of new product lines and ACN revenues. Subsequent to June 30, 1999, the Company added the new product lines of toys, electronics, software, video games, tools and hardware, lawn and patio, and kitchen products. At June 30, 2000, the number of customer accounts, which includes customer accounts for marketplace services but excludes customer accounts of our ACN partners, reached 22.5 million, compared with 10.7 million at June 30, 1999. Sales to customers outside of the US, including export sales from our US website and sales from our internationally focused Web sites located at www.amazon.co.uk and www.amazon.de, represented approximately 23% and 24% of net sales for the three months ended June 30, 2000 and 1999, and 23% for each of the six-month periods ended June 30, 2000 and 1999. Gross Profit 12 13 Gross profit consists of net sales less the cost of sales, which consists of the cost of merchandise sold to customers, as well as inbound and outbound shipping costs and the cost of tangible supplies used to package product for shipment to customers. For the three-month and six-month periods ended June 30, 2000, gross profit increased in absolute dollars over the same periods in 1999, reflecting our increased sales volume. Gross margin increased for the three-month and six-month periods ended June 30, 2000 compared to the same periods in 1999 primarily due to the generation of revenue from the higher-margin service activities of ACN. Gross profit from ACN activities was $23.6 million and $43.1 million for the three months and six months ended June 30, 2000. Excluding the effect of ACN, gross margin would have been 20.3% during the three months ended June 30, 2000 and 20.0% during the six months ended June 30, 2000, decreases of 1.2% and 1.8% compared to the same periods in 1999. This 1.8% decrease in gross margin (excluding ACN) for the six months ended June 30, 2000, as compared to the same period in 1999, is a result of lower gross profit from shipping and the addition of new product lines that generated lower gross margins. Gross profit from shipping, which represents shipping revenues less outbound shipping costs, declined to $7.5 million (5.1% of shipping revenues) from $11.6 million (12.4% of shipping revenues) for the six-month periods ended June 30, 2000 and 1999, respectively. The change in gross profit from shipping for these periods is primarily a function of the addition of the toys, electronics, tools and hardware and lawn and patio product lines since June 30, 1999, which have had lower shipping margins than books, music and DVD/video products. It is also a result of our distribution center expansion during 1999, which led to increased split-shipments. For the three months ended June 30, 2000 as compared to the same period in 1999, gross profit from shipping remained constant at 9.6% of shipping revenues. The 1.2% decrease in gross margin (excluding ACN) for the three-month period ended June 30, 2000 as compared to the same period in 1999 is primarily a function of the addition of new product lines that generated lower gross margins. We intend to continue to expand our operations by promoting new or complementary products or sales formats and by expanding the breadth and depth of our product and service offerings. Gross margins attributable to new business areas may be different from those associated with our existing business activities. To the extent such business areas become larger components of our sales, we would expect a corresponding impact on overall gross margin. Marketing, Sales and Fulfillment Marketing, sales and fulfillment expenses consist of advertising, promotional and public relations expenditures, credit card fees and payroll and related expenses for personnel engaged in marketing, selling and fulfillment activities. Fulfillment costs represent costs incurred in operating and staffing distribution and customer service centers (including costs attributable to receiving, inspecting and warehousing inventories; picking, packaging and preparing customers' orders for shipment; and responding to inquiries from customers), and credit card fees. Fulfillment costs amounted to $87.6 million and $42.4 million for the three-month periods ended June 30, 2000 and 1999, and $187.1 million and $76.5 million for the six-month periods ended June 30, 2000 and 1999. Advertising, promotional and public relations costs totaled $42.2 million and $43.8 million for the three-month periods ended June 30, 2000 and 1999, and $82.8 million and $70.4 million for the six-month periods ended June 30, 2000 and 1999. Marketing, sales and fulfillment expenses increased primarily due to increased payroll and related costs associated with fulfilling customer demand and increased credit card fees resulting from higher sales. Marketing, sales and fulfillment expenses decreased as a percentage of net sales for the three months ended June 30, 2000 as compared to the same period in 1999, from 27.4% of net sales in 1999 to 22.5% of net sales in 2000, due to decreased marketing expenses. Marketing, sales and fulfillment expenses also decreased as a percentage of net sales for the six-month period ended June 30, 2000 as compared to the same period in 1999, from 24.2% of net sales in 1999 to 23.4% of net sales in 2000, primarily due to decreased marketing expenses. The decrease in marketing expenses as a percentage of net sales outweighed an increase in fulfillment expenses as a percentage of net sales caused by the significant expansion of our distribution center network during 1999. We expect that fulfillment costs will decline as a percentage of net sales in the future as we improve efficiency in distribution and customer service and as additional capacity of our existing distribution center network is more fully utilized. However, due to risks related to seasonality, inventory management and other factors, fulfillment costs may not decline as a percentage of net sales. See "Additional Factors That May Affect Future Results." In July 2000, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue 00-10, "Accounting for Shipping and Handling Fees and Costs." This consensus requires that all amounts billed to a customer in a sale transaction related to shipping and handling, if any, represent revenue and should be classified as revenue. The Company already classifies shipping charges to customers as revenue. The EITF did not reach a consensus with respect to the classification of costs related to shipping and handling incurred by the seller. The Company classifies inbound and outbound shipping costs and the cost of tangible supplies used to package product for shipment to customers as cost of sales. The Company does not currently impose separate handling charges on customers and classifies costs incurred in operating and staffing distribution and customer service centers (including costs attributable to receiving, inspecting and warehousing inventories; picking, packaging and preparing customers' orders for shipment; and responding to inquiries from customers) and credit 13 14 card fees as marketing, sales and fulfillment expenses. It is possible that organizations responsible for promulgating accounting standards may address the classification of costs related to shipping and handling incurred by a seller in the future. Technology and Content Technology and content expenses consist principally of payroll and related expenses for development, editorial, systems and telecommunications operations personnel and consultants; systems and telecommunications infrastructure; and costs of acquired content, including freelance reviews. Technology and content expenses were 10.9% and 9.5% of net sales for the three-month and six-month periods ended June 30, 1999, increasing to 11.6% and 11.1% for the three-month and six-month periods ended June 30, 2000. The increase in technology and content expenses for the three-month and six-month periods ended June 30, 2000 as compared to the same periods in 1999, both in absolute dollars and as a percentage of sales, was primarily attributable to expenses associated with preparations for opening a second data center to house the Company's technology equipment, as well as expenses associated with developing content for the Company's Web sites for new product launches. Technology and content costs are generally expensed as incurred, except for costs incurred during the application and infrastructure development stage of internal-use software, including those related to the Company's Web sites, that are capitalized and depreciated over estimated useful lives (generally two years). We believe that continued investment in technology and content is critical to attaining our strategic objectives. In addition to ongoing investments in our Web stores and infrastructure, we intend to increase investments in products, services and international expansion. As a result, we expect technology and content expenses to continue to increase in absolute dollars. General and Administrative General and administrative expenses consist of payroll and related expenses for executive, finance and administrative personnel, recruiting, professional fees and other general corporate expenses. The increase in general and administrative expenses for the three-month and six-month periods ended June 30, 2000 as compared to the same periods in 1999 was primarily a result of increased salaries and related expenses associated with the hiring of additional personnel and legal and other professional fees. As a percentage of net sales, general and administrative expenses were 4.6% and 4.2% for the three-month and six-month periods ended June 30, 1999, increasing to 4.9% and 4.7% for the three-month and six-month periods ended June 30, 2000. These increases are primarily due to legal and other professional fees increasing as a percentage of net sales. Stock-Based Compensation Stock-based compensation is comprised of the portion of acquisition-related consideration that is conditioned on the continued tenure of key employees of acquired businesses, which must be classified as compensation expense rather than as a component of purchase price under generally accepted accounting principles. Stock-based compensation also includes stock-based charges for certain other compensation and severance arrangements. The increase in stock-based compensation for the three-month and six-month periods as compared to the same periods in 1999 resulted primarily from acquisitions consummated in 1999. Amortization of Goodwill and Other Intangibles Increases in amortization of goodwill and other intangibles for the three-month and six-month periods ended June 30, 2000 as compared to the same periods in 1999 primarily resulted from the 1999 acquisitions of e-Niche Incorporated (Exchange.com), Alexa Internet, Accept.com Financial Services Corporation, LiveBid.com, Inc., the catalog and online commerce assets of Acme Electric Motor Co. (Tool Crib of the North) and Back to Basics Toys, Inc. and other acquisitions. We may continue to expand our business through acquisitions, which would cause amortization of goodwill and other intangibles to increase. Loss from Operations Our loss from operations increased for the three-month and six-month periods ended June 30, 2000 as compared to the same periods in 1999 due to increases in marketing, sales and fulfillment, technology and content, general and administrative expenses, stock-based compensation and amortization of goodwill and other intangibles. The increases in these expense categories were partially offset by an increase in gross profit. Interest Income and Expense 14 15 Interest income decreased slightly for the three-month and six-month periods ended June 30, 2000 as compared to the same periods in 1999 due to a lower average balance of cash equivalents and marketable securities in 2000. Interest expense increased due to the February 2000 issuance of E690,000,000 ($656,397,000 as of June 30, 2000) of PEACS. Other Expense, Net Other expense, net primarily consists of net realized gains and losses on sales of marketable securities and net foreign exchange transaction gains and losses. The increase in other expense, net for the three-month and six-month periods ended June 30, 2000 as compared to the same periods in 1999 is primarily due to higher net foreign exchange transaction losses and higher net realized losses on sales of marketable securities during 2000. The increase in net foreign exchange transaction losses is commensurate with an increase in foreign exchange transactions, primarily in the first quarter related to the issuance of the PEACS, and the increase in net realized losses is a result of a decline in the value of debt instruments in an environment of rising interest rates. Equity in Losses of Equity-Method Investees Equity in losses of equity-method investees represents our share of losses of companies in which we have investments that give us the ability to exercise significant influence, but not control, over an investee. The increase in the amounts recorded for equity in losses of equity-method investees for the three-month and six-month periods ended June 30, 2000, as compared to the comparable periods in 1999, is due to a substantial increase in the number of investments that are accounted for under the equity method, as well as increased net losses of the investees. As of June 30, 1999, the Company had four equity-method investments, three of which were made during the three-month period ended June 30, 1999. As of June 30, 2000, the Company had 11 equity-method investments. We expect to make additional investments in the future that will be accounted for under the equity method of accounting. Most of the companies in which we have invested to date are in the early stage of their operations and are incurring net losses. Therefore, we expect to continue to record losses on our equity-method investments. Two of our equity-method investees, HomeGrocer.com, Inc. (HomeGrocer) and Pets.com, Inc., completed the initial public offerings of their common stock during the six months ended June 30, 2000. Additionally, another of our equity-method investees, drugstore.com, inc., completed a secondary offering of its common stock during the six months ended June 30, 2000. In connection with these sales of common stock by our investees, we recorded the related unrealized gains as contributions to additional paid-in capital of a total of $77.8 million during the six months ended June 30, 2000, representing the difference between the fair value and the carrying value of the portion of our investments that have been deemed to have been sold by the investees. In June 2000, HomeGrocer agreed to an acquisition of all of its outstanding common stock by Webvan Group, Inc. Upon closing of this transaction, the Company will no longer account for its investment in HomeGrocer under the equity method as its investment will not give it the ability to exercise significant influence over the combined entity. As a result, the Company will record a gain or loss representing the difference between the fair value and the recorded book value of the investment upon closing of the transaction. As of June 30, 2000, the book value of the Company's investment in HomeGrocer averaged $1.89 per share and the Company owned 27,733,990 shares of HomeGrocer common stock. The Company expects to record additional equity-method losses in HomeGrocer prior to closing of the transaction. The Company has agreed to certain restrictions on sale of the Webvan Group, Inc. common stock it will receive upon closing of the transaction. Pro Forma Results of Operations Pro forma information regarding our results, which excludes amortization of goodwill and other intangibles, stock-based compensation, equity in losses of equity-method investees and merger, acquisition and investment-related costs, is as follows:

THREE MONTHS ENDED SIX MONTHS ENDED JUNE 30, JUNE 30, ------- ------------------ ---------- --------------- 2000 1999 2000 1999 --------- ------- -- --------- --------- (IN THOUSANDS, EXCEPT (IN THOUSANDS, EXCEPT PER SHARE DATA) PER SHARE DATA) ~~Pro forma loss from operations .... $ (89,349) $ (67,252) $(188,615) $ (97,824) Pro forma net loss .... $(115,704) $ (82,786) $(237,239) $(119,120) Pro forma basic and diluted loss per share.................................... $ (0.33) $ (0.26) $ (0.68) $ (0.37) Shares used in computation of pro forma basic and diluted loss per share .... 349,886 322,340 346,680 318,106~~

15 16 Presentation of pro forma results from operations on the face of the financial statements is not in conformity with generally accepted accounting principles. We are providing pro forma results of operations for informational purposes only. The pro forma results are derived from information recorded in our financial statements. We expect that our pro forma loss from operations will continue to decline as a percentage of net sales, that our pro forma loss from operations will be less than 10% of net sales for the fourth quarter of 2000, and that our US Books, Music and DVD/video segment will generate income on a pro forma operating basis for the full year in 2000. However, any such projections are subject to substantial uncertanty. See "Additional Factors That May Affect Future Results." FINANCIAL CONDITION At June 30, 2000 the Company's total balance of cash and cash equivalents and marketable securities was $907.6 million, compared to $706.2 million at December 31, 1999. Cash and cash equivalents increased from $133.3 million at December 31, 1999 to $720.4 million at June 30, 2000 as a result of the investment of the proceeds from the issuance of the PEACS into a money market fund that is a cash equivalent. Marketable securities decreased from $572.9 million at December 31, 1999 to $187.2 million at June 30, 2000 because marketable securities were liquidated during the period to fund the Company's operating cash outflow for the period. Net cash used in operating activities was $390.7 million and $46.8 million for the six-month periods ended June 30, 2000 and 1999. Our net operating cash flow for both periods was primarily a result of our operating loss, exclusive of certain non-cash expenses resulting from depreciation and amortization, equity in losses of equity-method investees and amortization of goodwill and other intangibles. For further information regarding our operating cash flows, see the Statements of Cash Flows included in our unaudited interim financial statements. Net cash provided by (used in) investing activities was $286.9 million and $(925.7) million for the six-month periods ended June 30, 2000 and 1999, and consisted of net purchases and sales of marketable securities, purchases of fixed assets and cash paid for equity investments. Cash available for investment purposes increased substantially in both 2000 and 1999 as a result of the issuances of the PEACS and Convertible Notes. Net cash provided by financing activities of $690.8 million and $1.1 billion for the six-month periods ended June 30, 2000 and 1999, was primarily a result of the issuances of the PEACS and Convertible Notes in 2000 and 1999. As of June 30, 2000, the Company's principal commitments consisted of obligations outstanding under the PEACS, Convertible Notes, 10% Senior Discount Notes due May 2008 (the "Senior Discount Notes") and leases of property and equipment. The Company believes that current cash and marketable securities balances will be sufficient to meet its anticipated cash needs for at least the next 12 months and that it will generate positive cash flow from operations over the final two quarters of fiscal 2000 combined. The Company also expects that it will have approximately $1 billion in cash and cash equivalents and marketable securities as of December 31, 2000. However, any projections of future cash flows are subject to substantial uncertainty. See "Additional Factors That May Affect Future Results." If current cash, marketable securities and cash that may be generated from operations are insufficient to satisfy the Company's liquidity requirements, the Company may seek to sell additional equity or debt securities or to obtain a line of credit. The sale of additional equity or convertible debt securities could result in additional dilution to the Company's stockholders and additional interest expense. In addition, the Company will, from time to time, consider the acquisition of or investment in complementary businesses, products, services and technologies, and the repurchase and retirement of debt, which might impact the Company's liquidity requirements or cause the Company to issue additional equity or debt securities. There can be no assurance that financing will be available in amounts or on terms acceptable to the Company, if at all. ADDITIONAL FACTORS THAT MAY AFFECT FUTURE RESULTS In addition to the factors discussed in the "Overview" and "Financial Condition" sections of this "Management's Discussion and Analysis of Financial Condition and Results of Operations", the following additional factors may affect the Company's future results: WE HAVE A LIMITED OPERATING HISTORY UPON WHICH YOU CAN EVALUATE OUR BUSINESS AND PROSPECTS We have a relatively short operating history upon which you can evaluate our business and prospects. You should consider our prospects in light of the risks, expenses and difficulties

frequently encountered by online commerce companies. As an online commerce company, we have a rapidly evolving and unpredictable business model, we face intense competition, we must effectively manage our growth, and we must respond quickly to rapid changes in customer demands, industry standards and technology. We may not succeed in addressing these challenges and risks. WE HAVE AN ACCUMULATED DEFICIT AND ANTICIPATE FURTHER LOSSES 16 17 We have incurred significant losses since we began doing business. As of June 30, 2000, we had an accumulated deficit of $1.51 billion and our stockholders' equity was a deficit of $278.4 million. While we expect to generate income on a pro forma operating basis in our US Books, Music and DVD/video segment for the full year in 2000, we are incurring substantial operating losses and will continue to incur such losses for the foreseeable future. These losses may be significantly higher than our current losses. To succeed, we must invest heavily in marketing and promotion and in developing our product offerings and technology and operating infrastructure. Today's tight labor market and the recent volatility in our stock price could force us to increase our cash compensation to employees or grant larger stock option awards than we have historically, which could hurt our operating results and/or reduce the percentage ownership of our existing stockholders. In addition, the expenses associated with our past and future acquisitions and investments and interest expense related to our outstanding debt securities will adversely affect our operating results. Our aggressive pricing programs have resulted in relatively low gross margins. Our historical revenue growth rates are not sustainable and our percentage growth rate will decrease in the future. OUR SIGNIFICANT AMOUNT OF INDEBTEDNESS COULD AFFECT OUR BUSINESS We have significant indebtedness. As of June 30, 2000, we had indebtedness under senior discount notes, convertible notes, capitalized lease obligations and other asset financings totaling approximately $2.15 billion. We may incur substantial additional debt in the future. Our indebtedness could: - make it difficult to make principal and interest payments on our debt, - make it difficult to obtain necessary additional financing for working capital, capital expenditures, debt service requirements or other purposes in the future, - limit our flexibility in planning for, or reacting to, changes in our business and competition, and - make it more difficult for us to react in the event of an economic downturn. We may not be able to meet our debt service obligations. If our cash flow is inadequate to meet our obligations, we may face substantial liquidity problems. If we are unable to generate sufficient cash flow or obtain funds for required payments, or if we fail to comply with other covenants in our indebtedness, we will be in default. This would permit our creditors to accelerate the maturity of our indebtedness. In addition, our PEACS are denominated in euros, not dollars, and the exchange ratio between the euro and the dollar is not fixed by the indenture governing the PEACS. Therefore, fluctuations in the euro/dollar exchange ratio may adversely affect us, including by impacting the conversion. WE CANNOT ACCURATELY FORECAST REVENUES OF OUR BUSINESS. WE MAY EXPERIENCE SIGNIFICANT FLUCTUATIONS IN OUR QUARTERLY OPERATING RESULTS. OUR BUSINESS IS SUBJECT TO SEASONAL FLUCTUATION. FUTURE FLUCTUATIONS IN OPERATING RESULTS OR REVENUE SHORTFALLS COULD ADVERSELY AFFECT OUR SUCCESS Due to our limited operating history and the unpredictability of our industry, we cannot accurately forecast our revenues. We base our current and future expense levels on our investment plans and estimates of future revenues. Our expenses are to a large extent fixed. We may not be able to adjust our spending quickly if our revenues fall short of our expectations. Further, we may make pricing, purchasing, service, marketing, acquisition, investment or financing decisions that could adversely affect our business results. Our quarterly operating results will fluctuate for many reasons, including: - our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' demands, - our ability to acquire merchandise, manage our inventory and fulfill orders, - changes in gross margins of our current and future products and services, - the introduction by us or our competitors of Web sites, products or services, and our ability to properly anticipate demand, - purchases of large quantities of products, particularly in advance of the holidays, for which demand may not materialize, 17 18 - termination of Web sites, service offerings or product sales that we determine are not viable, - changes in usage of the Internet and online services and consumer acceptance of the Internet and online commerce, - timing of upgrades and developments in our systems and infrastructure, - the level of traffic on our Web sites, - the effects of acquisitions and other business combinations, and our ability to successfully integrate those acquisitions and business combinations, - technical difficulties, system downtime or Internet brownouts, - variations in the mix of products we sell, - changes in the mix of revenues derived from products as compared to services, - our inability to prevent fraud perpetrated by third parties through credit card transactions, Amazon Payments transactions, and auction and zShops transactions, - variations in our level of merchandise and vendor returns, and - disruptions in service by common shipping carriers due to strikes or otherwise. Both seasonal fluctuations in Internet usage and traditional retail seasonality are likely to affect our business. Internet usage generally declines during the summer. Sales in the traditional retail book, music, DVD/video, toy, electronics and tools and hardware industries usually increase significantly in the fourth calendar quarter of each year. The fourth quarter seasonal impact may be even more pronounced in our toys, electronics and video games businesses. For these reasons, you should not rely on period-to-period comparisons of our financial results to forecast our future performance. Our future operating results may fall below the expectations of securities analysts or investors, which would likely cause the trading price of our common stock to decline. WE COULD LOSE SUBSTANTIAL MARKET SHARE IF WE DO NOT KEEP UP WITH THE INTENSE COMPETITION IN THE ONLINE COMMERCE MARKET The online commerce market is new, rapidly evolving and intensely competitive. In addition, the retail book, music, DVD/video, toy, electronics, software, video game, tools and hardware, lawn and patio and kitchen industries are intensely competitive. Our current or potential competitors include: - online vendors of books, music, DVDs, videos, toys, electronics, software, video games, tools and hardware, lawn and patio products, kitchen products and other products, - a number of indirect competitors, including Web portals and Web search engines, that are involved in online commerce, either directly or in collaboration with other retailers, - online auction services, - Web-based retailers using alternative distribution capabilities, and - publishers, distributors, manufacturers and physical-world retailers of our products, many of which possess significant brand awareness, sales volume and customer bases, and some of which currently sell, or may sell, products or services through the Internet, mail order or direct marketing. 18 19 We believe that the principal competitive factors in our market include brand recognition, selection, personalized services, price, convenience, accessibility, customer service, quality of search tools, quality of editorial and other Web site content, reliability, speed of fulfillment, ease of use and our ability to adapt to changing conditions. Many of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we have. They may be able to secure merchandise from vendors on more favorable terms and may be able to adopt more aggressive pricing or inventory policies. They also can devote more resources to technology development and marketing than we can. As the online commerce market continues to grow, other companies may enter into business combinations or alliances that strengthen their competitive positions. Competition in the Internet and online commerce markets will intensify. As various Internet market segments obtain large, loyal customer bases, participants in those segments may use their market power to expand into the markets in which we operate. In addition, new and expanded Web technologies may increase the competitive pressures on online retailers. The nature of the Internet as an electronic marketplace may facilitate competitive entry and comparison shopping and render it inherently more competitive than conventional retailing formats. For example, "shopping agent" technologies permit customers to quickly compare our prices with those of our competitors. This increased competition may reduce our operating margins, diminish our market share or impair the value of our brand. SYSTEM INTERRUPTIONS AND THE LACK OF INTEGRATION AND REDUNDANCY IN OUR SYSTEMS MAY AFFECT THE VOLUME OF ORDERS WE FULFILL AND THEREFORE OUR REVENUES, AND MAY HAVE AN ADVERSE IMPACT ON THE VALUE OF OUR BRAND Customer access to our Web sites directly affects the volume of goods we sell and thus affects our revenues. We experience occasional system interruptions that make our Web sites unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. These interruptions will continue. We need to add additional software and hardware and upgrade our systems and network infrastructure to accommodate both increased traffic on our Web sites and increased sales volume and to fully integrate our systems. Without these upgrades, we may face additional system interruptions, slower response times, diminished customer service, impaired quality and speed of order fulfillment and delays in our financial reporting. We cannot accurately project the rate or timing of any increases in traffic or sales volume on our Web sites and, therefore, the integration and timing of these upgrades are uncertain. In addition, our inventory management systems are not fully integrated with our financial reporting systems, and a significant amount of manual effort may be necessary to reconcile our inventory and other financial accounts. We maintain substantially all of our computer and communications hardware at a single leased facility in Seattle, Washington. Our systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, break-ins, earthquake and similar events. We do not have backup systems or a formal disaster recovery plan, and we may not have sufficient business interruption insurance to compensate us for losses from a major interruption. Computer viruses, physical or electronic break-ins and similar disruptions could cause system interruptions, delays and loss of critical data and could significantly diminish our reputation and brand name and prevent us from providing services and accepting and fulfilling customer orders. OUR PLANNED GROWTH WILL CONTINUE TO PLACE A SIGNIFICANT STRAIN ON OUR MANAGEMENT, OPERATIONAL AND FINANCIAL RESOURCES We have rapidly and significantly expanded our operations and will further expand our operations to address potential growth of our product and service offerings and customer base. This expansion will continue to place a significant strain on our management, operational and financial resources. We need to continue to successfully execute our expansion of our distribution centers and customer service centers and continue to improve our transaction-processing and operational and financial systems, procedures and controls. We also need to expand, train and manage our employee base. Our current and planned personnel, systems, procedures and controls may not be adequate to support and effectively manage our future operations. We may not be able to hire, train, retain, motivate and manage required personnel or to successfully identify, manage and exploit market opportunities, which may limit our growth. WE FACE SIGNIFICANT INVENTORY RISK ARISING OUT OF CHANGES IN CONSUMER DEMAND AND PRODUCT CYCLES. WE FACE ADDITIONAL INVENTORY RISKS BECAUSE OUR INVENTORY MANAGEMENT SYSTEMS ARE NOT WELL INTEGRATED DUE TO THE MANUAL NATURE OF SOME OF OUR OPERATIONAL PROCESSES 19 20 We are exposed to significant inventory risks as a result of seasonality, new product launches, rapid changes in product cycles and changes in consumer tastes with respect to our products. In order to be successful, we must accurately predict these trends and avoid overstocking or understocking products. Demand for products, however, can change significantly between the time inventory is ordered and the date of sale. In addition, when we begin selling a new product, it is particularly difficult to forecast product demand accurately. These issues are particularly pronounced with respect to our inventory of products that are based on current trends. A failure to optimize inventory will harm our shipping margins by requiring us to make partial shipments from one or more locations. We may also be exposed to inventory risk if we are unable to negotiate satisfactory terms and conditions with our manufacturers, distributors and other suppliers. The acquisition of certain types of inventory, or inventory from certain sources, may require a significant lead-time and pre-payment, and such inventory may not be returnable. We carry a broad selection and significant inventory levels of products, and we may be unable to sell products in sufficient quantities or during the relevant selling seasons. We are also exposed to significant inventory risks because our inventory forecasting, purchasing, receiving, reconciliation, accounting and payment systems are not well developed and are not well integrated. The lack of systems integration makes it a difficult and manual process to receive inventory, reconcile inventory invoices to purchase orders, account for inventory efficiently, request refunds from suppliers and pay supplier invoices. In addition, certain manual operational processes further complicate our ability to manage inventory efficiently. Any one of the factors set forth above may require us to mark-down or write-off inventory. Substantial inventory mark-downs or write-offs will decrease gross margins. In the fourth quarter of 1999, for example, we incurred inventory-related charges that significantly decreased our gross margins. ENTERING NEW BUSINESS AREAS WILL REQUIRE SIGNIFICANT EXPENSE AND COULD STRAIN MANAGEMENT, FINANCIAL AND OPERATIONAL RESOURCES We intend to expand our operations by promoting new or complementary products, services or sales formats and by expanding our product or service offerings. This will require significant additional expense and could strain our management, financial and operational resources. We cannot expect to benefit in these new markets from the first-to-market advantage that we experienced in the online book market. Our gross margins in these new business areas may be lower than our existing business activities. In addition, we may have limited or no experience in these new business areas. We may not be able to expand our operations in a cost-effective or timely manner. Any new business that our customers do not receive favorably could damage our reputation and brand name. IF WE DO NOT SUCCESSFULLY EXPAND AND OPERATE OUR DISTRIBUTION CENTERS, OUR BUSINESS COULD BE HARMED If we do not successfully expand and our distribution centers fail to operate properly, it could significantly limit our ability to meet customer demand. During the fiscal year ended December 31, 1999, we added distribution centers in Nevada, Georgia, Kentucky, Kansas, North Dakota, Germany and the UK. Most of these distribution centers are or will be highly automated, and we have had limited experience with automated distribution centers. The two distribution centers we operated prior to 1999, in Washington and Delaware, are manually operated. We are not experienced in coordinating and managing distribution operations in geographically distant locations. Because it is difficult to predict sales increases, we may over-expand our facilities, which may result in excess inventory, warehousing, fulfillment and distribution capacity. We need to retain flexibility within our distribution and logistics network, including the ability to manage the operational challenges of shipping non-uniform and heavy products as part of the fulfillment of toy, electronics, tools and hardware, lawn and patio, kitchen and other product orders. THE DISPROPORTIONATE AMOUNT OF OUR NET SALES THAT WE EXPECT TO REALIZE DURING THE FOURTH QUARTER OF OUR FISCAL YEAR PLACES SIGNIFICANT STRAIN ON OUR BUSINESS Because we expect a disproportionate amount of our net sales to be realized during the holiday season in the fourth quarter of our fiscal year, we face significant risks in the fourth quarter. We may fail to accurately predict the optimal inventory levels at our distribution centers for the fourth quarter. If we do not stock popular products in sufficient amounts during the fourth quarter and fail to meet customer demand, it could significantly impact our revenue and our future growth. If we overstock products, we may be required to take significant inventory mark-downs or write-offs, which could reduce gross margins. In the fourth quarter of 1999, we incurred inventory-related charges, which significantly decreased our gross margins. A failure to optimize inventory at our distribution centers will harm our shipping margins by requiring us to make partial shipments from one or more locations. In addition, we may experience a decline in our shipping margins due to complimentary upgrades and split-shipments necessary to ensure timely delivery 20 21 for the holiday season. If too many customers access our Web sites within a short period of time due to increased holiday demand, we may experience system interruptions that make our Web sites unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services, and may also harm our brand. In addition, we may be unable to adequately staff our distribution and customer service centers during these peak periods. Finally, our new automated distribution centers may fail to operate properly, which would interfere with our ability to meet customer demand. We expect that our inventory balance will increase substantially in advance of the Christmas holiday. Payments for purchases of much of this inventory will not occur until the first quarter of the following fiscal year. Because we are paid for sales of product upon shipment, we anticipate an increase in available cash in the fourth quarter of our fiscal year, followed by a decrease in the first quarter as we make payments for inventory purchased in the previous fiscal year. WE MAY NOT BE SUCCESSFUL IN OUR EFFORTS TO EXPAND INTO INTERNATIONAL MARKETS We plan to expand rapidly our presence in international markets. We have relatively little experience in purchasing, marketing and distributing products or services for these markets and may not benefit from any first-to-market advantages. It will be costly to establish international facilities and operations, promote our brand internationally, and develop localized Web sites and stores and other systems. We may not succeed in our efforts in these countries. Our revenues from international activities may not offset the expense of establishing and maintaining foreign operations and therefore these operations may never be profitable. Our international sales and operations are subject to a number of risks inherent in selling and operating abroad, including, but not limited to, risks with respect to: - currency exchange rate fluctuations, - local economic and political conditions, - restrictive governmental actions (such as trade protection measures, including export duties and quotas and custom duties and tariffs), - changes in legal or regulatory requirements, - import or export licensing requirements, - limitations on the repatriation of funds, - difficulty in obtaining distribution and support, - nationalization, - different accounting practices and potentially longer payment cycles, - seasonal reductions in business activity, - higher costs of doing business, - consumer protection laws and restrictions on pricing or discounts, - lower level of adoption or use of the Internet and other technologies vital to our business, and the lack of or the failure to implement the appropriate infrastructure to support widespread Internet usage, - lower level of credit card usage, - difficulty in developing staffing and simultaneously managing a larger number of unique foreign operations as a result of distance, language and cultural differences, - disruptions of capital and trading markets, 21 22 - laws and policies of the US affecting trade, foreign investment and loans, and - tax and other laws. As the international online commerce market continues to grow, competition in this market will likely intensify. Local companies may have a substantial competitive advantage because of their greater understanding of and focus on the local markets, as well as their more established local brand name recognition. In addition, governments in foreign jurisdictions may regulate the Internet or other online services in such areas as content, privacy, network security, copyright, encryption or distribution. This may affect our ability to conduct business internationally. We may not be able to hire, train, retain, motivate and manage required personnel, which may limit our growth in international markets. OUR BUSINESS COULD SUFFER IF WE ARE UNSUCCESSFUL IN MAKING AND INTEGRATING BUSINESS COMBINATIONS AND STRATEGIC ALLIANCES We plan to continue to expand our operations and market presence by entering into business combinations, investments, joint ventures or other strategic alliances with other companies. Business combinations, investments, joint ventures and other strategic alliances with other companies create risks such as: - difficulty assimilating the operations, technology and personnel of combined companies, - disruption of our ongoing business, including loss of management focus on existing businesses and other market developments, - problems retaining key technical and managerial personnel, - expenses associated with amortization of goodwill and other purchased intangible assets, - additional operating losses and expenses of acquired businesses, - impairment of relationships with existing employees, customers and business partners, and - fluctuations in value and losses that may arise from our equity investments. We may not succeed in addressing these risks. We may not be able to identify suitable candidates for business combinations and strategic investments or to make such business combinations and strategic investments on terms that are acceptable to us. In addition, the businesses we have acquired, and in the future may acquire, may incur operating losses. OUR AMAZON COMMERCE NETWORK SUBJECTS US TO A NUMBER OF RISKS In the fall of 1999, we began our Amazon Commerce Network (ACN) program. As part of this program, we enter into agreements with companies in which we agree to jointly establish co-branded sections of the Amazon Web site for the sale of products and services by these companies. In exchange for the services we provide under these agreements, we receive cash, equity securities of these companies, or a combination of the two. Since beginning the ACN program, we have entered into agreements with 15 different companies. As part of this program, we may in the future enter into additional agreements with both existing ACN partners or new companies. We hold several investments in third parties that are accounted for using the equity method, including several investments in our ACN partners. Under the equity method, we are required to record our equity percentage of the income or losses of these companies as income or losses for us. We record these amounts generally one month in arrears for private companies and one quarter in arrears for public companies. At June 30, 2000, we accounted for our investments in nine ACN partners under the equity method, three of which are public companies and six of which are private companies. The public companies are drugstore.com, HomeGrocer.com and Pets.com. The companies in which we have equity method investments are engaged in the Internet and e-commerce industries, are likely to experience large losses for the forseeable future and may not be successful. While 22 23 the future losses we will record under the equity method are limited to our investment balance, we expect to record additional equity method losses in the future. Our investments in equity securities not accounted for under the equity method are included in "Marketable securities" and "Other investments" on our balance sheet. Certain of these investments are also in ACN partners. We regularly review all of our investments in public and private companies for permanent impairment. If we determine that an investment is permanently impaired, we would reduce the carrying value of the securities we hold in these companies, perhaps by the entire amount being carried on our balance sheet, and record a loss in the amount of that impairment. Through June 30, 2000, we had not recorded any permanent impairment for any investment, although we had unrealized losses of $89.6 million on available-for-sale securities included in accumulated other comprehensive loss as of June 30, 2000 and have recorded $198.7 million of equity-method losses for the six months ended June 30, 2000. In recent months, companies in the Internet and e-commerce industries have experienced difficulties, including difficulties in raising proceeds to fund expansion or to continue operations. Because the companies in which we have investments are part of the Internet and e-commerce industries, we may conclude in future quarters that some of these investments have been permanently impaired. We have recently entered into amendments and negotiations to restructure our agreements with certain ACN partners. We have accepted or have been asked to accept lower future cash payments, revisions to the related term of the agreements, or both. To the extent lower future cash payments in future years resulted from these modifications, the amount recorded as unearned revenue is being recognized as revenue over a longer period of time than contemplated under the terms of the original agreements. See Note 6 of Notes to Financial Statements. WE MAY NOT BE ABLE TO ADAPT QUICKLY ENOUGH TO CHANGING CUSTOMER REQUIREMENTS AND INDUSTRY STANDARDS Technology in the online commerce industry changes rapidly. We may not be able to adapt quickly enough to changing customer requirements and preferences and industry standards. Competitors often introduce new products and services with new technologies. These changes and the emergence of new industry standards and practices could render our existing Web sites and proprietary technology obsolete. To succeed, we must enhance our Web site responsiveness, functionality and features, acquire and license leading technologies, enhance our existing services, develop new services and technology and respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis. THE LOSS OF KEY SENIOR MANAGEMENT PERSONNEL COULD NEGATIVELY AFFECT OUR BUSINESS We depend on the continued services and performance of our senior management and other key personnel, particularly Jeffrey P. Bezos, our chief executive officer and chairman of the board. We do not have "key person" life insurance policies. The loss of any of our executive officers or other key employees could harm our business. THE LONG-TERM VIABILITY OF THE INTERNET AS A MEDIUM FOR COMMERCE IS NOT CERTAIN Consumer use of the Internet as a medium for commerce is a recent phenomenon and is subject to a high level of uncertainty. While the number of Internet users has been rising, the Internet infrastructure may not expand fast enough to meet the increased levels of demand. The increased use of the Internet as a medium for commerce raises concerns regarding Internet security, reliability, pricing, accessibility and quality of service. If use of the Internet as a medium for commerce does not continue to grow, or grows at a slower rate than we anticipate, or if the necessary Internet infrastructure or complementary services are not developed to effectively support growth that may occur, our business would be harmed. WE MAY BE SUBJECT TO PRODUCT LIABILITY CLAIMS IF PEOPLE OR PROPERTY ARE HARMED BY THE PRODUCTS WE SELL As we enter new lines of business, we may increasingly sell products, such as toys, tools and hardware products and kitchen products, that may increase our exposure to product liability claims relating to personal injury, death or property damage caused by such products, and that may require us to take actions such as product recalls. We maintain liability insurance, but we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, if at all. In addition, some of our vendor agreements with our suppliers do not indemnify us from product liability. 23 24 WE RELY ON A SMALL NUMBER OF SUPPLIERS; OUR BUSINESS WOULD BE HARMED IF OUR CURRENT SUPPLIERS STOP SELLING MERCHANDISE TO US ON ACCEPTABLE TERMS Although we have recently continued to increase our direct purchasing from manufacturers, approximately 25% of all of our purchases and 35% of our book, music, DVD and video titles, during the three months ended June 30, 2000 were from three major vendors, Ingram Book Group, Baker & Taylor, Inc. and Valley Media, Inc., from which we purchase book, music, DVD and video titles. We do not have long-term contracts or arrangements with most of our vendors to guarantee the availability of merchandise, particular payment terms or the extension of credit limits. Our current vendors may stop selling merchandise to us on acceptable terms. We may not be able to acquire merchandise from other suppliers in a timely and efficient manner and on acceptable terms. WE MAY NOT BE ABLE TO ACQUIRE OR MAINTAIN APPROPRIATE DOMAIN NAMES We hold rights to various Web domain names, including "Amazon.com," "Amazon.co.uk," "Amazon.de" and "zShops.com." Governmental agencies typically regulate domain names. These regulations are subject to change. We may not be able to acquire or maintain appropriate domain names in all countries in which we do business. Furthermore, regulations governing domain names may not protect our trademarks and similar proprietary rights. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or diminish the value of our trademarks and other proprietary rights. GOVERNMENT REGULATION OF INTERNET COMMERCE IS EVOLVING AND UNFAVORABLE CHANGES COULD HARM OUR BUSINESS We are subject to general business regulations and laws or regulations regarding taxation and access to online commerce. These laws or regulations may impede the growth of the Internet or other online services. Regulatory authorities may adopt specific laws and regulations governing the Internet or online commerce. These regulations may cover taxation, user privacy, pricing, content, copyrights, distribution, electronic contracts, and characteristics and quality of products and services. Changes in consumer protection laws also may impose additional burdens on companies conducting business online, both in the US and internationally. It is not clear how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet and online commerce. Unfavorable resolution of these issues may harm our business. In addition, many jurisdictions currently regulate "auctions" and "auctioneers" in conducting auctions and may regulate online auction services. Jurisdictions may also regulate consumer-to-consumer fixed price online markets, like zShops. This could, in turn, diminish the demand for our products and services and increase our cost of doing business. IF WE ARE REQUIRED TO COLLECT TAXES IN ADDITIONAL JURISDICTIONS ON THE PRODUCTS WE SELL, WE MAY BE SUBJECT TO LIABILITY FOR PAST SALES AND OUR FUTURE SALES MAY DECREASE In accordance with current industry practice, we do not currently collect sales taxes or other taxes with respect to shipments of goods into states other than Washington. In addition, we collect Value Added Tax, or VAT, for products that are ordered on www.amazon.co.uk and www.amazon.de and shipped into European Union member countries. Our new distribution center and customer service center networks, and any future expansion of those networks, along with other aspects of our evolving business, may result in additional sales and other tax obligations. One or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies which engage in electronic commerce as we do. A successful assertion by one or more states or foreign countries that we should collect sales or other taxes on the sale of merchandise could result in substantial tax liabilities for past sales, decrease our ability to compete with traditional retailers and otherwise harm our business. Recent federal legislation limits the imposition of US state and local taxes on Internet-related sales. In 1998, Congress passed the Internet Tax Freedom Act, which places a three-year moratorium on state and local taxes on Internet access, unless such tax was already imposed prior to October 1, 1998, and on discriminatory taxes on electronic commerce. There is a possibility that Congress may not renew this legislation in 2001. If Congress chooses not to renew this legislation, US state and local governments would be free to impose new taxes on electronically purchased goods. The imposition of taxes on goods sold over the Internet by US state and local governments would create administrative burdens for us and decrease our future sales. The

European Commission is currently evaluating its VAT position on electronic commerce transactions. It is possible that future VAT legislation in the European Union or changes to our business model may result in additional VAT collection obligations and administrative burdens. 24 25 WE COULD BE LIABLE FOR UNLAWFUL OR FRAUDULENT ACTIVITIES BY USERS OF OUR AUCTION, ART AND COLLECTIBLES, AND zSHOPS SERVICES We may be unable to prevent users of our auction, art and collectibles, and zShops services from selling unlawful goods, or from selling goods in an unlawful manner. We may face civil or criminal liability for unlawful and fraudulent activities by our users. Any costs we incur as a result of liability relating to the sale of unlawful goods, the unlawful sale of goods, the fraudulent receipt of goods or the fraudulent collection of payments could harm our business. In running our auction, art and collectibles and zShops services, we rely on sellers of goods to make accurate representations and provide reliable delivery and on buyers to pay the agreed purchase price. For our auction, art and collectibles, and zShops services, we do not take responsibility for delivery of payment or goods and while we can suspend or terminate the accounts of users who fail to fulfill their delivery obligations to other users, we cannot require users to make payments or deliver goods. We do not compensate users who believe they have been defrauded by other users except through our guarantee program. Under the guarantee program, fraudulent activities by our users, such as the fraudulent receipt of goods and the fraudulent collection of payments, may create liability for us. In addition, we are aware that governmental agencies are currently investigating the conduct of online auctions. WE COULD BE LIABLE FOR BREACHES OF SECURITY ON OUR WEB SITE AND FRAUDULENT ACTIVITIES OF USERS OF OUR AMAZON PAYMENTS PROGRAM A fundamental requirement for electronic commerce is the secure transmission of confidential information over public networks. Although we have developed systems and processes to prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may impact our financial results. The law relating to the liability of providers of online payment services is currently unsettled. We guarantee payments made through Amazon Payments up to certain limits for both buyers and sellers, and we may be unable to prevent users of Amazon Payments from fraudulently receiving goods when payment may not be made to a seller or fraudulently collecting payments when goods may not be shipped to a buyer. Our liability risk will increase as a larger fraction of our sellers use Amazon Payments. Any costs we incur as a result of liability because of our guarantee of payments made through Amazon Payments or otherwise could harm our business. In addition, the functionality of Amazon Payments depends on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, Amazon Payments will not be viable (and our businesses that use Amazon Payments may not be viable). WE COULD BE SUBJECT TO RISKS ASSOCIATED WITH INFORMATION POSTED ON OUR WEB SITE BY THIRD PARTIES Our Web site features customer reviews of the products we sell and customer ratings of sellers on our auctions and zShops sites. Although these reviews and ratings are generated by customers and not by us, it is possible that a claim could be made against us for reviews and ratings posted on our Web site. If we become liable for information posted on our Web site by customers, we could be harmed and may be forced to discontinue certain services. WE MAY NOT BE ABLE TO ADEQUATELY PROTECT OUR INTELLECTUAL PROPERTY RIGHTS OR MAY BE ACCUSED OF INFRINGING INTELLECTUAL PROPERTY RIGHTS OF THIRD PARTIES We regard our trademarks, service marks, copyrights, patents, trade dress, trade secrets, proprietary technology and similar intellectual property as critical to our success, and we rely on trademark, copyright and patent law, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. We have been issued a number of trademarks, service marks, patents and copyrights by US and foreign governmental authorities. We also have applied for the registration of some other trademarks, service marks, copyrights and patents in the US and internationally. In addition, we have filed US and international patent applications covering certain of our proprietary technology. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our products and services are made available online. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Third parties that license our proprietary rights, such as trademarks, patented technology or copyrighted material, may take actions that diminish the value of our proprietary rights or reputation. In addition, the steps we take to protect our proprietary rights may not be adequate and third parties may infringe or misappropriate our copyrights, trademarks, trade dress, patents and similar proprietary 25 26 rights. Other parties may claim that we infringed their proprietary rights. We have been subject to claims, and expect to continue to be subject to legal proceedings and claims, regarding alleged infringement by our licensors and us of the trademarks and other intellectual property rights of third parties. Such claims, whether or not meritorious, may result in the expenditure of significant financial and managerial resources, injunctions against us or the imposition of damages that we must pay. We may need to obtain licenses from third parties who allege that we have infringed their rights, but such licenses may not be available on terms acceptable to us, or at all. OUR STOCK PRICE IS HIGHLY VOLATILE The trading price of our common stock fluctuates significantly. For example, during the 52-week period ended June 30, 2000 (as adjusted for the 2-for-1 split of our common stock on September 1, 1999), the reported sale price of our common stock on the NASDAQ National Market was as high as $113.00 and as low as $32.47 per share. Trading prices of our common stock may fluctuate in response to a number of events and factors, such as: - quarterly variations in operating results, - announcements of innovations, - new products, services and strategic developments by us or our competitors, or business combinations and investments by us or our competitors, - changes in financial estimates and recommendations by securities analysts, - changes in interest rates or other general economic conditions, - conditions or trends in the Internet and the online commerce industry, - developments in Internet regulation, - sales of our common stock in the open market, - additions or departures of key personnel, - changes in the valuation of or performance by other online commerce companies, and - news reports relating to trends in the Internet, products we currently sell or in the future may sell, or services we perform or in the future may perform. Any of these events may cause our stock price to fall, which may adversely affect our business and financing opportunities. The valuations of many Internet stocks are high based on conventional valuation standards such as price to earnings and price to sales ratios. In addition, the stock market in general and the market prices for Internet-related companies in particular have experienced significant volatility that often has been unrelated or disproportionate to such companies' operating performance. These broad market and industry fluctuations may adversely affect the trading price of our common stock regardless of our operating performance. In the past, securities class action litigation has been more likely to be brought against various companies following a period of volatility in the market price of their securities. We may be the target of similar litigation in the future, which could result in substantial costs and divert management's attention and resources, which could seriously harm our financial condition and operating results. ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK The Company is exposed to market risk for the impact of interest rate changes, foreign currency fluctuations and changes in the market values of its investments. The Company has not utilized derivative financial instruments in its investment portfolio. Interest rate risk. The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio and its long-term debt. All of the Company's marketable securities are designated as available for sale and accordingly are presented at fair value on our balance sheets. The Company generally invests its excess cash in high quality short- to intermediate-term fixed income securities and money market mutual funds. Fixed rate securities may have their fair market value 26 27 adversely impacted due to a rise in interest rates, and the Company may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates. Foreign currency risk. Revenues from the Company's foreign subsidiaries accounted for 13% of total revenues for the three months and six months ended June 30, 2000. Sales made by the Company's foreign subsidiaries are typically denominated in the local currency of each country. These subsidiaries also incur most of their expenses in the local currency. Accordingly, all foreign subsidiaries use the local currency as their functional currency. The Company is also exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into US dollars in consolidation. As exchange rates vary, these results, when translated, may vary from expectations and adversely impact overall expected profitability. The effect of foreign exchange rate fluctuations on the Company in the quarter ended June 30, 2000 was not material. At June 30, 2000, the Company was also exposed to foreign currency risk related to the euro-denominated PEACS, which have an outstanding principal balance of E690 million ($656.4 million as of June 30, 2000) and expose the Company to risks of fluctuations in the euro/US dollar exchange rate. At June 30, 2000, the Company held E698.4 million ($664.4 million) in a euro-denominated money market fund, which provides offsetting changes in exchange rate fluctuations. Additionally, because the conversion option in the PEACS is denominated in euros, changes in the euro/US dollar exchange rate may affect the future conversion of the debt. Investment risk. The Company invests in both private and public companies, including its ACN partners, primarily for strategic purposes. Such investments are accounted for under the equity method if they give the Company the ability to exercise significant influence, but not control, over an investee. This is generally defined as an ownership interest of the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's Board of Directors and the impact of commercial arrangements, are considered in determining whether the equity method is appropriate. Some of the Company's cost-method investments are in private companies and are accounted for at cost and others are in public companies and are accounted for as available-for-sale securities and recorded at fair value. The Company regularly reviews the carrying value of its investments and identifies and records impairment losses when events and circumstances indicate that such assets are permanently impaired. To date, the Company has not recorded any such impairment losses. As of June 30, 2000, the Company had equity-method investments of $211.7 million, investments in private companies recorded under the cost method of $26.6 million, and available-for-sale equity securities at fair value totaling $77.2 million ($15.5 million of which was included in marketable securities and $61.7 million of which was included in other investments). All of these investments are in companies involved in the Internet and e-commerce industries and their fair values are subject to significant fluctuations due to volatility of the stock market and changes in general economic conditions. 27 28 PART II -- OTHER INFORMATION ITEM 1. LEGAL PROCEEDINGS During the first quarter of 2000, Supnick v. Amazon.com and Alexa Internet and four similar class action complaints were filed against the Company and its wholly owned subsidiary, Alexa Internet. The complaints, which have been consolidated in the United States District Court for the Western District of Washington, allege that Alexa Internet's tracking and storage of Internet Web usage paths violates federal and state statutes prohibiting computer fraud, unfair competition, and unauthorized interception of private electronic communications, as well as common law proscriptions against trespass and invasion of privacy. The complaints seek actual, statutory and punitive damages, as well as restitution, on behalf of all users of Alexa Internet's Web navigation service, as well as injunctive relief prohibiting Alexa Internet from tracking and storing such information or disclosing it to third parties. Although the Company disputes the allegations of wrongdoing in these complaints, there can be no assurance that the Company will prevail in these lawsuits. In addition, the Federal Trade Commission has requested information and documents regarding Alexa Internet's practices and has opened a formal investigative file in connection with its inquiry. The Commission is seeking to determine whether the Company has engaged in unfair or deceptive acts in connection with the advertisement and operation of certain services provided by Alexa. The Company is cooperating voluntarily with the Commission's investigation. Depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect the Company's business, future results of operations or cash flows in a particular period. From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights, patents and other intellectual property rights. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on its business, prospects, financial condition or operating results. ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS None ITEM 3. DEFAULTS UPON SENIOR SECURITIES None ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS The Company's annual meeting of stockholders was held on May 10, 2000. The following nominees were elected as directors, each to hold office until his or her successor is elected and qualified, by the vote set forth below:

NOMINEE
FOR
WITHHELD

---- --------
--- ---------
-- ~~Jeffrey P. Bezos~~
~~.............~~
~~314,795,113~~
~~895,025~~
~~Tom A. Alberg~~
~~................~~
~~315,210,320~~
~~479,818~~
~~Scott D. Cook~~
~~................~~
~~307,151,459~~
~~8,538,679~~
~~L. John Doerr~~
~~................~~
~~314,736,128~~
~~954,010~~
~~Joseph Galli, Jr. ....~~
~~314,427,144~~
~~1,262,994~~
~~Patricia Q. Stonesifer~~
~~.......~~
~~315,126,708~~
~~563,430~~

The proposal to approve an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares of common stock from 1,500,000,000 shares to 5,000,000,000 shares and increase the number of authorized shares of preferred stock from 150,000,000 shares to 500,000,000 shares was approved by the vote set forth below: FOR AGAINST ABSTAIN 228,632,499 16,518,120 259,892 28 29 The proposal to approve the amendment to the Company's 1997 Stock Option Plan was approved by the vote set forth below: FOR AGAINST ABSTAIN 295,884,941 19,303,196 502,001 ITEM 5. OTHER INFORMATION None ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K (a) Exhibits

EXHIBIT NUMBER TITLE ----------- ~~3.1 Restated Certificate of Incorporation of the Company 3.2 Restated Bylaws of the Company 10.1 Executive Compensation Letter to Jeff Wilke, dated May 16, 2000 10.2 Executive Compensation Letter to Warren Jenson, dated May 16, 2000 12.1 Computation of Ratio of Earnings to Fixed Charges 18.1 Letter Regarding Change in Accounting Principles 27.1 Financial Data Schedule~~

---------- (b) Reports on Form 8-K On May 1, 2000, the Company filed a Form 8-K under Item 5 announcing the Company's financial results for the first quarter of 2000. 29 30 SIGNATURES Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. AMAZON.COM, INC. (Registrant) DATED: August 2, 2000 By: /s/ MARK S. PEEK ------------------------------------ Mark S. Peek Chief Accounting Officer and Vice President, Finance 30 31 EXHIBIT INDEX

EXHIBIT NUMBER TITLE ------ ----- ~~3.1 Restated Certificate of Incorporation of the Company (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarterly Period ended March 31, 2000) 3.2 Restated Bylaws of the Company (incorporated by reference to the Company's Current Report on Form 8-K dated February 28, 2000) 10.1 Executive Compensation Letter to Jeff Wilke, dated May 16, 2000 10.2 Executive Compensation Letter to Warren Jenson, dated May 16, 2000 12.1 Computation of Ratio of Earnings to Fixed Charges 18.1 Letter Regarding Change in Accounting Principles 27.1 Financial Data Schedule~~
