UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2006

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 Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

1200 12th Avenue South, Suite 1200, Seattle, Washington 98144-2734
(206) 266-1000
(Address and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

411,922,555 shares of common stock, par value $0.01 per share, outstanding as of October 20, 2006

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AMAZON.COM, INC.

FORM 10-Q
For the Quarterly Period Ended September 30, 2006

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		Twelve Months Ended September 30,	
	2006	2005	2006	2005	2006	2005
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 683	$ 629	$1,013	$ 1,303	$ 600	$ 746
OPERATING ACTIVITIES:						
Net income	19	30	93	160	292	507
Adjustments to reconcile net income to net cash from operating activities:						
Depreciation of fixed assets, including internal-use software and website development, and other amortization	63	30	146	85	182	106
Stock-based compensation	30	26	71	71	87	90
Other operating expense	2	—	9	3	13	(3)
Losses (gains) on sales of marketable securities, net	(3)	—	(2)	—	(4)	—
Remeasurements and other	(1)	(6)	(10)	(38)	(14)	(6)
Non-cash interest expense and other	1	1	3	4	4	5
Deferred income taxes	7	23	15	116	(31)	(128)
Cumulative effect of change in accounting principle	—	—	—	(26)	—	(26)
Changes in operating assets and liabilities:						
Inventories	(218)	(76)	(155)	10	(269)	(98)
Accounts receivable, net and other current assets	(53)	(12)	13	6	(77)	14
Accounts payable	252	147	(187)	(224)	312	201
Accrued expenses and other current liabilities	27	(6)	(44)	(72)	87	(3)
Additions to unearned revenue	39	28	131	95	192	120
Amortization of previously unearned revenue	(35)	(32)	(125)	(87)	(187)	(118)
Net cash provided by (used in) operating activities	130	153	(42)	103	587	661
INVESTING ACTIVITIES:						
Purchases of fixed assets, including internal-use software and website development	(62)	(76)	(166)	(149)	(221)	(186)
Acquisitions, net of cash acquired	(2)	(4)	(30)	(24)	(30)	(24)
Sales and maturities of marketable securities and other investments	438	163	975	653	1,159	1,072
Purchases of marketable securities	(227)	(289)	(589)	(1,027)	(947)	(1,475)
Net cash provided by (used in) investing activities	147	(206)	190	(547)	(39)	(613)
FINANCING ACTIVITIES:						
Proceeds from exercises of stock options	4	21	17	38	36	55
Excess tax benefit on stock awards	9	2	38	4	43	4
Common stock repurchased	(252)	—	(252)	—	(252)	—
Proceeds from long-term debt and other	13	13	81	13	81	13
Repayments of long-term debt and capital lease obligations	(42)	(6)	(376)	(272)	(376)	(272)
Net cash provided by (used in) financing activities	(268)	30	(492)	(217)	(468)	(200)
Foreign-currency effect on cash and cash equivalents	1	(6)	24	(42)	13	6
Net increase (decrease) in cash and cash equivalents	10	(29)	(320)	(703)	93	(146)
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 693	$ 600	$ 693	$ 600	$ 693	$ 600
SUPPLEMENTAL CASH FLOW INFORMATION:						
Cash paid for interest	$ 22	$ 21	$ 85	$ 105	$ 85	$ 105
Cash paid for income taxes	5	6	13	11	15	12

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net sales	$ 2,307	$ 1,858	$ 6,725	$ 5,513
Cost of sales	1,758	1,395	5,119	4,141
Gross profit	549	463	1,606	1,372
Operating expenses (1):				
Fulfillment	217	171	599	495
Marketing	64	44	171	131
Technology and content	172	121	485	319
General and administrative	54	32	150	117
Other operating expense	2	40	9	43
Total operating expenses	509	408	1,414	1,105
Income from operations	40	55	192	267
Interest income	14	12	41	30
Interest expense	(21)	(22)	(58)	(70)
Other income, net	4	—	4	2
Remeasurements and other	1	6	10	38
Total non-operating expense	(2)	(4)	(3)	—
Income before income taxes	38	51	189	267
Provision for income taxes	19	21	96	133
Income before cumulative effect of change in accounting principle	19	30	93	134
Cumulative effect of change in accounting principle	—	—	—	26
Net income	$ 19	$ 30	$ 93	$ 160
Basic earnings per share:				
Prior to cumulative effect of change in accounting principle	$ 0.05	$ 0.07	$ 0.22	$ 0.33
Cumulative effect of change in accounting principle	—	—	—	0.06
	$ 0.05	$ 0.07	$ 0.22	$ 0.39
Diluted earnings per share:				
Prior to cumulative effect of change in accounting principle	$ 0.05	$ 0.07	$ 0.22	$ 0.32
Cumulative effect of change in accounting principle	—	—	—	0.06
	$ 0.05	$ 0.07	$ 0.22	$ 0.38
Weighted average shares used in computation of earnings per share:				
Basic	417	413	417	411
Diluted	424	428	425	426
(1) Includes stock-based compensation as follows:				
Fulfillment	$ 8	$ 5	$ 18	$ 13
Marketing	1	2	3	5
Technology and content	16	13	38	36
General and administrative	5	6	12	17

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS
(in millions, except per share data)

	September 30, 2006 (unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 693	$ 1,013
Marketable securities	526	987
Inventories	736	566
Deferred tax assets, current portion	79	89
Accounts receivable, net and other current assets	281	274
Total current assets	2,315	2,929
Fixed assets, net	449	348
Deferred tax assets, long-term portion	180	223
Goodwill	194	159
Other assets	130	37
Total assets	$ 3,268	$ 3,696
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,196	$ 1,366
Accrued expenses and other current liabilities	572	563
Total current liabilities	1,768	1,929
Long-term debt and other	1,304	1,521
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value:		
Authorized shares — 500		
Issued and outstanding shares — none	—	—
Common stock, $0.01 par value:		
Authorized shares — 5,000		
Issued and outstanding shares — 411 and 416	4	4
Treasury stock, at cost	(252)	—
Additional paid-in capital	2,377	2,263
Accumulated other comprehensive income	1	6
Accumulated deficit	(1,934)	(2,027)
Total stockholders' equity	196	246
Total liabilities and stockholders' equity	$ 3,268	$ 3,696

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1 — Accounting Policies

Unaudited Interim Financial Information

We have prepared the accompanying consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These consolidated financial statements are unaudited and, in our opinion, include all adjustments, consisting of normal recurring adjustments and accruals necessary for a fair presentation of our consolidated balance sheets, operating results, and cash flows for the periods presented. Operating results for the periods presented are not necessarily indicative of the results that may be expected for 2006 due to seasonal and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our 2005 Annual Report on Form 10-K. Certain prior period amounts have been reclassified to conform to the current period presentation.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, and those entities (relating to *www.joyo.com*) in which we have a variable interest. Intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, valuation of investments, receivables valuation, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets, internally-developed software, valuation of acquired intangibles, income taxes, stock-based compensation, and contingencies. Actual results could differ materially from those estimates.

Earnings per Share

Basic earnings per share is calculated using our weighted-average outstanding common shares. Diluted earnings per share is calculated using our weighted-average outstanding common shares including the dilutive effect of stock awards. Using the treasury stock method, the effect of stock awards on the weighted average shares used in the computation of earnings per share was 7 million and 15 million shares for Q3 2006 and Q3 2005, and 8 million and 15 million shares for the nine months ended September 30, 2006 and 2005.

Our convertible debt instruments are excluded from the calculation of diluted earnings per share as their effect is antidilutive.

Treasury Stock

In Q3 2006, we repurchased shares of our common stock pursuant to authorization from our Board of Directors. We account for treasury stock under the cost method and include treasury stock as a component of stockholders' equity.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(unaudited)

Business Combinations

We acquired certain companies during the nine months ended September 30, 2006, for an aggregate purchase price of $50 million, including cash payments of $30 million in the nine months ended September 30, 2006, and future cash payments of $19 million and $1 million due in 2007 and 2008. Acquired intangibles totaled $17 million and have estimated useful lives of between one and ten years. The excess of purchase price over the fair value of the net assets acquired was $33 million and is classified as "Goodwill" on our consolidated balance sheets. The results of operations of the acquired businesses have been included in our consolidated results from each closing date forward. The effect of these acquisitions on consolidated net sales and operating income during the nine months ended September 30, 2006 was not significant.

Internal-use Software and Website Development

Costs incurred to develop software for internal use are required to be capitalized and amortized over the two year estimated useful life of the software in accordance with SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.* Costs related to design or maintenance of internal-use software are expensed as incurred. During Q3 2006 and Q3 2005, we capitalized $34 million (including $5 million of stock-based compensation) and $25 million (including $3 million of stock-based compensation) of costs associated with internal-use software and website development. For the nine months ended September 30, 2006 and 2005, we capitalized $92 million (including $12 million of stock-based compensation) and $65 million (including $8 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $23 million and $14 million for Q3 2006 and Q3 2005, and $61 million and $35 million for the nine months ended September 30, 2006 and 2005.

Depreciation of Fixed Assets

Fixed assets include assets such as furniture and fixtures, heavy equipment, technology infrastructure, internal-use software and website development, and our DVD rental library. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets (generally two years or less for assets such as internal-use software and our DVD rental library, two or three years for our technology infrastructure, five years for furniture and fixtures, and ten years for heavy equipment). Depreciation expense is generally classified within the operating expense categories on our consolidated statements of operations, and certain assets, such as our DVD rental library, are amortized as "Cost of sales." Depreciation expense for fixed assets was $62 million and $29 million for Q3 2006 and Q3 2005, and $141 million and $78 million for the nine months ended September 30, 2006 and 2005.

Other Assets

Included in "Other assets" on our consolidated balance sheets are amounts primarily related to deferred issuance charges on our long-term debt, certain equity investments, other intangibles, and restricted long-term marketable securities. At September 30, 2006 and December 31, 2005, deferred issuance charges were $8 million and $13 million; equity investments were $8 million and $8 million; and other intangibles, net were $24 million and $11 million. At September 30, 2006, marketable securities restricted for longer than one year were $83 million, primarily attributable to collateralization of debt related to our international operations; at December 31, 2005, these amounts were insignificant.

Accrued Expenses and Other Current Liabilities

Included in "Accrued expenses and other current liabilities" at September 30, 2006 and December 31, 2005 are liabilities of $135 million and $131 million for unredeemed gift certificates. We recognize revenue from a gift certificate when a customer redeems it. If a gift certificate is not redeemed, we recognize revenue when it expires or, for a certificate without an expiration date, when the likelihood of its redemption becomes remote, generally two years from date of issuance.

Unearned Revenue

Unearned revenue is recorded when payments are received or currently due in advance of performing our service obligations and is recognized ratably over the service period. Unearned revenue was $57 million and $48 million at September 30, 2006 and December 31, 2005. These amounts are included in "Accrued expenses and other current liabilities" on our consolidated balance sheets.

Income Taxes

Income tax expense includes U.S. and international income taxes, plus the provision for U.S. taxes on undistributed earnings of international subsidiaries not deemed to be permanently invested.

Certain items of income and expense are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes. See Note 8 — "Income Taxes." Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes,* requires that deferred tax assets be evaluated for future realization and be reduced by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carry-forward periods available to us for tax reporting purposes, and other relevant factors. Significant judgment is required in making this assessment, and it is very difficult to predict when, if ever, our assessment may conclude that the remaining portion of our deferred tax assets are realizable. In accordance with SFAS 109, we allocate our valuation allowance to current and long-term deferred tax assets on a pro-rata basis.

Shipping Activities

Outbound shipping charges to customers are included in "Net sales" and were $118 million and $112 million for Q3 2006 and Q3 2005, and $375 million and $323 million for the nine months ended September 30, 2006 and 2005. Outbound shipping-related costs are included in "Cost of sales" and totaled $182 million and $159 million for Q3 2006 and Q3 2005, and $567 million and $471 million for the nine months ended September 30, 2006 and 2005. The net cost to us of shipping activities was $64 million and $47 million for Q3 2006 and Q3 2005, and $192 million and $148 million for the nine months ended September 30, 2006 and 2005.

Stock-Based Compensation

In Q1 2005, we adopted SFAS 123(R) using the modified prospective method, which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The fair value of restricted stock and restricted stock units is determined based on the number of shares granted and the quoted price of our common stock, and the fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with our valuation techniques previously utilized for options in footnote disclosures required under SFAS 123, *Accounting for Stock Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation — Transition and Disclosure.* Such value is recognized as expense over the service period, net of estimated forfeitures, using the accelerated method under SFAS 123(R). The estimation of stock awards that will ultimately vest requires

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(unaudited)

judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

The adoption of SFAS 123(R) resulted in a cumulative benefit from accounting change of $26 million in Q1 2005, which reflects the net cumulative impact of estimating future forfeitures in the determination of period expense, rather than recording forfeitures when they occur as previously permitted.

Prior to the adoption of SFAS 123(R), cash retained as a result of tax deductions in excess of amounts reported for financial reporting purposes relating to stock-based compensation was presented in our consolidated statements of cash flows as operating cash flows, along with other tax cash flows, in accordance with the provisions of Emerging Issues Task Force (EITF) No. 00-15, *Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option.* SFAS 123(R) supersedes EITF 00-15, amends SFAS 95, *Statement of Cash Flows,* and requires tax benefits relating to excess stock-based compensation deductions to be prospectively presented in our consolidated statements of cash flows as financing cash flows. Tax benefits resulting from stock-based compensation deductions in excess of amounts reported for financial reporting purposes were $9 million and $2 million for Q3 2006 and Q3 2005, and $38 million and $4 million for the nine months ended September 30, 2006 and 2005.

Recently Issued Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109,* which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 will be effective beginning Q1 2007. We have not yet evaluated the impact of implementation on our consolidated financial statements.

Note 2 — Cash, Cash Equivalents, and Marketable Securities

As of September 30, 2006 and December 31, 2005 our cash, cash equivalents, and marketable securities primarily consisted of cash, investment grade securities and AAA-rated money market mutual funds.

We are required to pledge a portion of our marketable securities as collateral for standby letters of credit that guarantee certain of our contractual obligations, a line of credit, and real estate lease agreements. See “Note 4 — Commitments and Contingencies.”

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(unaudited)

Note 3 — Long-Term Debt and Other

Our long-term debt and other long-term liabilities are summarized as follows:

	September 30, 2006	December 31, 2005
	(in millions)	
4.75% Convertible Subordinated Notes due February 2009 (1)	$ 900	$ 900
6.875% PEACS due February 2010 (2)	304	580
Other long-term debt and capital lease obligations	170	44
	1,374	1,524
Less current portion of other long-term debt and capital lease obligations	(70)	(3)
Total long-term debt and other	$ 1,304	$ 1,521

(1) The 4.75% Convertible Subordinated Notes are convertible into our common stock at the holders' option at a conversion price of $78.0275 per share. Total common stock issuable upon conversion of our outstanding 4.75% Convertible Subordinated Notes is 11.5 million shares, which is excluded from our calculation of earnings per share as its effect is anti-dilutive. We have the right to redeem the 4.75% Convertible Subordinated Notes, in whole or in part, by paying the principal and a redemption premium, plus any accrued and unpaid interest. At September 30, 2006, the redemption premium, which decreases by 47.5 basis points on February 1 of each year until maturity, was 1.425%.

(2) In Q1 2006, we redeemed an aggregate principal amount of €250 million ($300 million based on the Euro to U.S. Dollar exchange rate on the date of redemption) of our outstanding 6.875% Premium Adjustable Convertible Securities due February 2010 ("6.875% PEACS"). Under the Indenture, no redemption premium is required. We recorded a charge in Q1 2006, classified in "Remeasurements and other," of approximately $6 million related to the redemption, consisting of $3 million in unamortized deferred issuance charges and $3 million relating to unrealized losses on our terminated currency swap that previously hedged a portion of our 6.875% PEACS. Accrued and unpaid interest of $1 million was also paid at redemption. The 6.875% PEACS are convertible into our common stock at the holders' option at a conversion price of €84.883 per share ($107.58 per share, based on the exchange rate as of September 30, 2006). Total common stock issuable upon conversion of our outstanding 6.875% PEACS is 2.8 million shares, which is excluded from our calculation of earnings per share as its effect is anti-dilutive. The U.S. Dollar equivalent principal, interest, and conversion price fluctuate based on the Euro/U.S. Dollar exchange ratio. We have the right to redeem the 6.875% PEACS, in whole or in part, by paying the principal plus any accrued and unpaid interest.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(unaudited)

Note 4 — Commitments and Contingencies

Commitments

We lease office and fulfillment center facilities and fixed assets under non-cancelable operating and capital leases. Rental expense under operating lease agreements was $21 million and $20 million for Q3 2006 and Q3 2005, and $99 million and $53 million for the nine months ended September 30, 2006 and 2005.

The following summarizes our principal contractual commitments, excluding open orders for purchases that support normal operations, as of September 30, 2006:

	Three Months Ending December 31, 2006	Year Ended December 31, 2007	2008	2009 (in millions)	2010	Thereafter	Total
Operating and capital commitments:							
Debt principal and other (1)	$ 11	$ 74	$ 9	$ 910	$ 344	$ 24	$ 1,372
Debt interest (1)	1	66	65	43	21	—	196
Operating leases (2) (3)	33	119	107	89	70	224	642
Total commitments	$ 45	$ 259	$ 181	$ 1,042	$ 435	$ 248	$ 2,210

(1) Under our 6.875% PEACS, the principal payment due in 2010 and the annual interest payments fluctuate based on the Euro/U.S. Dollar exchange ratio. At September 30, 2006, the Euro to U.S. Dollar exchange rate was 1.2674. Due to changes in the Euro/U.S. Dollar exchange ratio, our remaining principal debt obligation under this instrument since issuance in February 2000 has increased by $68 million as of September 30, 2006.

(2) Pursuant to SFAS 13, *Accounting for Leases*, lease agreements are categorized at their inception as either operating or capital leases depending on certain defined criteria. Although operating leases represent obligations for us, pursuant to SFAS 13 they are not reflected on our consolidated balance sheets. Of the $642 million remaining obligations under operating leases, $40 million relates to equipment operating leases. If we had applied to our equipment operating leases the same convention used for capital leases, which, however, would not be in accordance with GAAP, we would have recorded approximately $35 million of additional obligations on our consolidated balance sheets.

(3) Includes $8 million related to restructuring-related leases and other commitments, consisting of $4 million due within 12 months and included in “Accrued expenses and other current liabilities,” and $4 million due after 12 months and included in “Long-term debt and other” on our consolidated balance sheets. These amounts are net of anticipated sublease income of $4 million.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(unaudited)

Pledged Securities

We are required to support certain letters of credit, debt, and real estate leases by pledging or otherwise restricting cash and marketable securities. We classify marketable securities, where a use restriction exists for a period of twelve months or longer, as non-current "Other assets" on our consolidated balance sheets. The balance of pledged securities at September 30, 2006 consisted of $5 million in "Cash and cash equivalents", $67 million in "Marketable securities" and $83 million in "Other assets". The amount required to be pledged for certain real estate lease agreements changes over the life of our leases, and with fluctuations in our market capitalization and our credit rating. Information about collateral required to be pledged under these agreements is as follows:

	Standby and Trade Letters of Credit (1)	Debt (2)	Real Estate Leases (3)	Total
		(in millions)		
Balance at December 31, 2005	$ 59	$ 14	$ 18	$ 91
Net change in collateral pledged	21	41	2	64
Balance at September 30, 2006	$ 80	$ 55	$ 20	$155

(1) Pursuant to available standby and trade letter-of-credit facilities totaling $158 million.
(2) Represents collateral for certain debt related to our international operations.
(3) At September 30, 2006, our market capitalization was $13.2 billion. The required amount of collateral to be pledged will increase by $6 million if our market capitalization is equal to or below $13 billion and decrease by $5 million if our market capitalization exceeds $18 billion.

Legal Proceedings

The Company is involved from time to time in claims, proceedings and litigation, including the following:

In October 2002, Gary Gerlinger, individually and on behalf of all other similarly situated consumers in the United States who, during the period from August 1, 2001 to the present, purchased books online from either Amazon.com or Borders.com, instituted an action against us and Borders in the United States District Court for the Northern District of California. The complaint alleges that the agreement pursuant to which an affiliate of Amazon.com operates Borders.com as a co-branded site violates federal anti-trust laws, California statutory law, and the common law of unjust enrichment. The complaint seeks injunctive relief, damages, including treble damages or statutory damages where applicable, attorneys' fees, costs, and disbursements, disgorgement of all sums obtained by allegedly wrongful acts, interest, and declaratory relief. In November 2005, the Court dismissed all of the plaintiff's claims with prejudice. The plaintiff is appealing that dismissal. We dispute the allegations of wrongdoing in this complaint, and we will continue to defend ourselves vigorously in this matter.

Beginning in March 2003, we were served with complaints filed in several different states, including Illinois, by a private litigant purportedly on behalf of the state governments under various state False Claims Acts. The complaints allege that we (along with other companies with which we have commercial agreements) wrongfully failed to collect and remit sales and use taxes for sales of personal property to customers in those states and knowingly created records and statements falsely stating we were not required to collect or remit such taxes. The complaints seek injunctive relief, unpaid taxes, interest, attorneys' fees, civil penalties of up to $10,000 per violation, and treble or punitive damages under the various state False Claims Acts. It is possible that we have been or will be named in similar cases in other states as well. We do not believe that we are liable under existing laws and regulations for any failure to collect sales or other taxes relating to Internet sales and intend to vigorously defend ourselves in these matters.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(unaudited)

In April 2004, we learned that the French authorities are investigating our DVD sales practices in France, and we are cooperating.

In May 2004, Toysrus.com LLC filed a complaint against us for breach of contract in the Superior Court of New Jersey. The complaint alleged that we breached our commercial agreement with Toysrus.com LLC by selling, and by permitting other third parties to sell, products that Toysrus.com LLC alleged it has an exclusive right to sell on our website. We disputed the allegations in the complaint and brought counterclaims alleging breach of contract and seeking damages and declaratory relief. The trial of both parties' claims concluded in November 2005. In March 2006, the Court entered a judgment in favor of Toysrus.com LLC, terminating the contract but declining to award damages to either party. We are pursuing an appeal of the lower court's rulings terminating the contract, declining to award us damages, and denying our motion to compel Toysrus.com to pay certain fees incurred during the wind-down period.

In October 2004 Cendant Publishing, Inc. filed a complaint against us for patent infringement in the United States District Court for the District of Delaware. The complaint alleged that our website technology, including our recommendations features, infringes a patent obtained by Cendant purporting to cover a "System and Method for Providing Recommendation of Goods or Services Based on Recorded Purchasing History" (U.S. Patent No. 6,782,370) and sought injunctive relief, monetary damages in an amount no less than a reasonable royalty, prejudgment interest, costs, and attorneys' fees. In February 2005, Cendant voluntarily withdrew the complaint without prejudice. In June 2005, however, Cendant re-filed a new complaint containing substantially the same claims. In response, we filed a countersuit in the United States District Court for the Western District of Washington (since transferred to the District of Delaware) alleging that Cendant's parent, Cendant Corporation, and its affiliates Orbitz, Inc., Budget Rent A Car System, Inc., Avis Rent A Car System, Inc., and Trilegiant Corporation infringe certain patents owned by us and our subsidiary, A9.com. In October 2006, we settled both lawsuits on terms that, among other things, provide mutual non-exclusive cross licenses to the patents in suit.

In December 2005, Registrar Systems LLC filed a complaint against us and Target Corporation for patent infringement in the United States District Court for the District of Colorado. The complaint alleges that our website technology, including the method by which Amazon.com enables customers to use Amazon.com account information on websites that Amazon.com operates for third parties, such as Target.com, infringes two patents obtained by Registrar Systems purporting to cover methods and apparatuses for a "World Wide Web Registration Information Processing System" (U.S. Patent Nos. 5,790,785 and 6,823,327) and seeks injunctive relief, monetary damages in an amount no less than a reasonable royalty, prejudgment interest, costs, and attorneys' fees. We dispute the allegations of wrongdoing in this complaint and intend to vigorously defend ourselves in this matter. In September 2006, the Court entered an order staying the lawsuit pending the outcome of the Patent and Trademark Office's re-examination of the patents in suit.

In August 2006, Cordance Corporation filed a complaint against us for patent infringement in the United States District Court for the District of Delaware. The complaint alleges that our website technology, including our 1-Click ordering system, infringes a patent obtained by Cordance purporting to cover an "Object-Based Online Transaction Infrastructure" (U.S. Patent No. 6,757,710) and seeks injunctive relief, monetary damages in an amount no less than a reasonable royalty, treble damages for alleged willful infringement, prejudgment interest, costs, and attorneys' fees. In response, we asserted a declaratory judgment counterclaim in the same action alleging that a service that Cordance has advertised its intent to launch infringes a patent owned by us entitled "Networked Personal Contact Manager" (U.S. Patent No. 6,269,369). We dispute Cordance's allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In October 2006, IBM filed two patent infringement lawsuits against us in the United States District Court for the Eastern District of Texas. The complaints allege that various aspects of our website technology infringe five patents obtained by IBM purporting to cover a "System for Ordering Items Using an Electronic Catalog"

(U.S. Patent No. 5,319,542), a “Method for Storing Data in an Interactive Computer Network” (U.S. Patent No. 5,442,771), a “System for Adjusting Hypertext Links with Weighed User Goals and Activities” (U.S. Patent No. 5,446,891), a “Method for Presenting Applications in an Interactive Service” (U.S. Patent No. 5,796,967), and a “Method of Presenting Advertising in an Interactive Service” (U.S. Patent No. 7,072,849). The complaints seek injunctive relief, monetary damages in an amount no less than a reasonable royalty, treble damages for alleged willful infringement, prejudgment interest, and attorneys’ fees. We dispute the allegations of wrongdoing in these complaints and intend to vigorously defend ourselves in this matter.

Depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, results of operations, financial position, or cash flows in a particular period.

Note 5 — Stockholders’ Equity

Stock Repurchase Activity

In August 2006, our Board of Directors authorized a 24-month program to repurchase up to an aggregate of $500 million of our common stock. We repurchased 8 million shares of our common stock for $252 million in Q3 2006 under this program.

Stock Award Activity

We granted stock awards, which consist primarily of restricted stock units, representing 1 million shares of common stock during each of Q3 2006 and Q3 2005 with a per share weighted average fair value of $31.79 and $40.11. For the nine months ended September 30, 2006 and 2005, we granted stock awards representing 8 million and 6 million shares of common stock with a per share weighted average fair value of $36.28 and $35.90. Our annual stock awards are granted in the second quarter.

Common shares underlying outstanding stock awards were as follows:

	September 30, 2006	December 31, 2005
	(in millions)	
Stock options (1)	10	12
Restricted stock units	14	10
Total outstanding stock awards	24	22

(1) The weighted average per share exercise price was $15.52 and $14.28 at September 30, 2006 and December 31, 2005.

Common shares outstanding, plus shares underlying outstanding stock options and restricted stock units, was 435 million and 438 million at September 30, 2006 and December 31, 2005. These totals include all stock-based awards outstanding, without regard for estimated forfeitures, consisting of vested and unvested awards, and in-the-money and out-of-the-money stock options.

The following table summarizes our restricted stock unit activity for the nine months ended September 30, 2006 (in millions):

	Number of Units
Outstanding at December 31, 2005	10
Units granted	8
Units vested	(1)
Units cancelled	(3)
Outstanding at September 30, 2006	14

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Scheduled vesting for outstanding restricted stock units at September 30, 2006 is as follows (in millions):

	Three Months Ending December 31,	Year Ended December 31,				
	2006	2007	2008	2009	2010 and Thereafter	Total
Scheduled vesting—restricted stock units	1	4	5	2	2	14

As of September 30, 2006, there was $224 million of net unrecognized compensation cost related to unvested stock-based compensation arrangements. This compensation is recognized on an accelerated basis resulting in approximately half of the compensation expected to be expensed in the next twelve months, and has a weighted average recognition period of 1.5 years.

Note 6 — Comprehensive Income

Comprehensive income was $22 million and $16 million for Q3 2006 and Q3 2005, and $87 million and $141 million for the nine months ended September 30, 2006 and 2005. The primary differences between net income as reported and comprehensive income are foreign currency translation adjustments and changes in unrealized gains and losses on available-for-sale securities.

Note 7 — Remeasurements and Other

Remeasurements and other consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)		(in millions)	
Foreign-currency gain (loss) on remeasurement of 6.875% PEACS	$ 3	$ 4	$ (24)	$ 81
Loss on redemption of long-term debt	—	—	(6)	(4)
Foreign-currency effect on intercompany balances	(4)	(2)	37	(41)
Other	2	4	3	2
Total remeasurements and other	$ 1	$ 6	$ 10	$ 38

Note 8 — Income Taxes

Our tax provision for interim periods is determined using an estimate of our annual effective tax rate. The effective tax rates in Q3 2006 and for the nine months ended September 30, 2006 were higher than the 35% statutory rate, resulting from steps we initiated to establish our European headquarters in Luxembourg, which we expect will benefit our effective tax rate over time. Associated with the establishment of our European headquarters, we transferred certain of our operating assets in 2005 and 2006 from the U.S. to international locations. These transfers resulted in taxable income and an increase in our effective tax rate. We expect the transfers will result in an effective tax rate for financial reporting purposes higher than the statutory rate throughout 2006. Since we have deferred tax assets related to our net operating losses (NOLs), these asset transfers are not expected to have a significant impact on our cash taxes paid in 2006. Cash paid for income taxes was $5 million and $6 million in Q3 2006 and Q3 2005, and $13 million and $11 million for the nine months ended September 30, 2006 and 2005.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(unaudited)

Note 9 — Segment Information

We have organized our operations into two principal segments: North America and International. We present our segment information along the same lines that our chief executive reviews our operating results in assessing performance and allocating resources.

We allocate to segment results the operating expenses "Fulfillment," "Marketing," "Technology and content," and "General and administrative," but exclude from our allocations the portions of these expense lines attributable to stock-based compensation. Additionally, we do not allocate the line item "Other operating expense" to our segment operating results. A significant majority of our costs for "Technology and content" are incurred in the United States and most of these costs are allocated to our North America segment. There are no internal revenue transactions between our reporting segments.

Information on reportable segments and reconciliation to consolidated net income is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)		(in millions)	
North America				
Net sales	$ 1,257	$ 1,041	$ 3,661	$ 3,028
Cost of sales	914	749	2,668	2,179
Gross profit	343	292	993	849
Direct segment operating expenses	321	226	885	645
Segment operating income	$ 22	$ 66	$ 108	$ 204
International				
Net sales	$ 1,050	$ 817	$ 3,064	$ 2,485
Cost of sales	844	646	2,451	1,962
Gross profit	206	171	613	523
Direct segment operating expenses	156	116	449	346
Segment operating income	$ 50	$ 55	$ 164	$ 177
Consolidated				
Net sales	$ 2,307	$ 1,858	$ 6,725	$ 5,513
Cost of sales	1,758	1,395	5,119	4,141
Gross profit	549	463	1,606	1,372
Direct segment operating expenses	477	342	1,334	991
Segment operating income	72	121	272	381
Stock-based compensation	(30)	(26)	(71)	(71)
Other operating expense	(2)	(40)	(9)	(43)
Income from operations	40	55	192	267
Total non-operating expense, net	(2)	(4)	(3)	—
Provision for income taxes	(19)	(21)	(96)	(133)
Cumulative effect of change in accounting principle	—	—	—	26
Net income	$ 19	$ 30	$ 93	$ 160

Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding guidance, industry prospects or future results of operations or financial position, made in this Quarterly Report on Form 10-Q are forward-looking. We use words such as anticipates, believes, expects, future, intends, and similar expressions to identify forward-looking statements. Forward-looking statements reflect management's current expectations and are inherently uncertain. Actual results could differ materially for a variety of reasons, including, among others, fluctuations in foreign exchange rates, changes in global economic conditions and consumer spending, world events, the rate of growth of the Internet and online commerce, the amount that Amazon.com invests in new business opportunities and the timing of those investments, the mix of products sold to customers, the mix of net sales derived from products as compared with services, competition, management of growth, potential fluctuations in operating results, international growth and expansion, outcomes of legal proceedings and claims, fulfillment center optimization, risks of inventory management, seasonality, the degree to which the Company enters into, maintains, and develops commercial agreements, acquisitions, and strategic transactions, payments risks, and risks of fulfillment throughput and productivity. These risks and uncertainties, as well as other risks and uncertainties that could cause our actual results to differ significantly from management's expectations, are described in greater detail in Item 1A of Part II, "Risk Factors," which, along with the previous discussion, describes some, but not all, of the factors that could cause actual results to differ significantly from management's expectations.

Overview

Our primary source of revenue is the sale of a wide range of products and services to customers. The products offered on our websites include products we have purchased from distributors, publishers, and manufacturers and products offered by third parties. Generally, we recognize gross revenue from items we sell from our inventory and recognize our net share of revenue of items sold by third parties. We offer services such as Amazon Enterprise Solutions, co-branded credit cards, and miscellaneous marketing and promotional offers.

Our financial focus is on long-term, sustainable growth in free cash flow[1]. Free cash flow is driven primarily by increasing operating income and efficiently managing working capital and capital expenditures. Increases in operating income result from increases in sales through our websites and a focus on keeping our operating costs low, offset by investments we make in longer-term strategic initiatives including hiring additional software engineers and computer scientists. To increase sales, we focus on improving all aspects of the customer experience, including lowering prices, improving availability, offering faster delivery times, increasing selection, expanding product information, improving ease of use, and earning customer trust. We generally focus on gross profit and operating profit dollars rather than margin percentages. Because we have deferred tax assets from net operating loss carryforwards, the free cash flow impact from income taxes paid is less than our income tax provision.

We also seek to efficiently manage shareholder dilution while maintaining the flexibility to issue shares for strategic purposes, such as financings and aligning employee interests with shareholders'. We utilize restricted stock units as our primary vehicle for equity compensation because we believe they better align the interests of our shareholders and employees. Restricted stock units result in charges to our consolidated statements of operations based on the fair value of the awards at the grant date recorded over the underlying service periods,

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1 Free cash flow, a non-GAAP financial measure, is defined as net cash provided by operating activities less purchases of fixed assets, including capitalized internal-use software and website development, both of which are presented on our consolidated statements of cash flows. See Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Non-GAAP Financial Measures."

net of estimated cancellations. Total shares outstanding plus outstanding stock awards were 435 million and 438 million at September 30, 2006 and December 31, 2005. These totals include all stock awards outstanding, without regard for estimated forfeitures, consisting of vested and unvested awards, and in-the-money and out-of-the-money stock options.

We seek to reduce our customer experience variable costs per unit and work to leverage our customer experience fixed costs. Our customer experience variable costs include product costs, payment processing and related transaction costs, picking, packaging, and preparing orders for shipment, transportation, customer service support, and most aspects of our marketing costs. Our customer experience fixed costs include the costs necessary to build, enhance, and add features to our websites and build and optimize our fulfillment centers. Variable costs generally change directly with sales volume, while fixed costs generally increase depending on the timing of capacity needs, geographic expansion, and other factors. To decrease our variable costs on a per unit basis and enable us to lower prices for customers, we seek to increase our direct to publisher and manufacturer sourcing, maximize discounts available to us from suppliers and reduce defects in our processes. To minimize growth in fixed costs, we seek to improve process efficiencies and maintain a lean culture.

Because of our model we are able to turn our inventory quickly and have a negative operating cycle[2]. On average, our high inventory velocity means we generally collect from our customers before our payments to suppliers come due. Inventory turnover[3] was 13 and 15 for Q3 2006 and Q3 2005. We expect some variability in inventory turnover over time since it is affected by several factors, including our product mix, our mix of third-party sales, our continuing focus on in-stock inventory availability, our future investment in new geographies and product lines, and the extent we choose to utilize outsource fulfillment providers. Accounts payable days[4] were 63 and 58 for Q3 2006 and Q3 2005. We expect some variability in accounts payable days over time since it is affected by several factors, including the mix of product sales, the mix of third-party sales, the mix of suppliers, seasonality, and changes in payment terms over time, including the effect of negotiating better pricing from our suppliers in exchange for shorter payment terms.

Our spending in technology and content will increase as we add computer scientists, software engineers, and employees involved in editorial content, buying, merchandising, and systems support. We will continue to invest in several areas of technology, including seller platforms, web services, and digital initiatives, as well as in technology infrastructure to enhance the customer experience and improve our process efficiencies. We believe that advances in technology, specifically the speed and reduced cost of processing power, the improved consumer experience of the Internet outside of the workplace through lower-cost broadband service to the home, and the advances of wireless connectivity, will continue to improve the consumer experience on the Internet and increase its ubiquity in people’s lives. Our challenge will be to continue to build and deploy innovative and efficient software that will best take advantage of continued advances in technology.

Our financial reporting currency is the U.S. Dollar and changes in exchange rates significantly affect our reported results and consolidated trends. For example, if the U.S. Dollar weakens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit, and operating expenses will be higher than if currencies had remained constant. Likewise, if the U.S. Dollar strengthens year-over-year relative to currencies in our international locations, our consolidated net sales, gross profit, and operating expenses will be lower than if currencies had remained constant. We believe that our increasing diversification beyond the U.S. economy through our growing international businesses benefits our shareholders over the long term. We also

2 The operating cycle is number of days of sales in inventory plus number of days of sales in accounts receivable minus accounts payable days.

3 Inventory turnover is the quotient of trailing twelve month cost of sales to average inventory over five quarters.

4 Accounts payable days is the quotient of accounts payable to cost of sales, multiplied by the number of days in the period.

believe it is important to evaluate our operating results and growth rates before and after the effect of currency changes.

In addition, the remeasurement of our 6.875% PEACS and intercompany balances can result in significant gains and charges associated with the effect of movements in currency exchange rates. Currency volatilities may continue, which may significantly impact (either positively or negatively) our reported results and consolidated trends and comparisons.

Critical Accounting Judgments

The preparation of financial statements in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The SEC has defined a company's critical accounting policies as the ones that are most important to the portrayal of the company's financial condition and results of operations, and which require it to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we have identified the critical accounting policies and judgments addressed below. We also have other key accounting policies, which involve the use of estimates, judgments, and assumptions that are significant to understanding our results. For additional information, see Item 8 of Part II, "Financial Statements and Supplementary Data — Note 1 — Description of Business and Accounting Policies," of our 2005 Annual Report on Form 10-K. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions.

Revenue Recognition

We recognize revenue from product sales or services rendered when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility is reasonably assured. Additionally, revenue arrangements with multiple deliverables are divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: the delivered item has value to the customer on a standalone basis; there is objective and reliable evidence of the fair value of undelivered items; and delivery of any undelivered item is probable.

We evaluate the criteria of EITF 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. Generally, when we are the primary party obligated in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not primarily obligated and amounts earned are determined using a percentage, a fixed-payment schedule, or a combination of the two, we generally record the net amounts as commissions earned. Under our Syndicated Stores arrangements, we record gross product sales and costs since we own the inventory, set prices, and are responsible for fulfillment and customer service, and the other business earns a sales commission.

Product sales and shipping revenues, net of promotional discounts, rebates, and return allowances, are recorded when the products are shipped and title passes to customers. Retail items sold to customers are made pursuant to sales contracts that generally provide for transfer of both title and risk of loss upon our delivery to the carrier. Return allowances, which reduce product revenue by our best estimate of expected product returns, are estimated using historical experience. Amounts paid in advance for subscription services, including amounts received for online DVD rentals, Amazon Prime, and other membership programs, are deferred and classified as unearned revenue in "Accrued expenses and other current liabilities" on our consolidated balance sheets and recognized as revenue over the subscription term.

We periodically provide incentive offers to our customers to encourage purchases. Such offers include current discount offers, such as percentage discounts off current purchases, inducement offers, such as offers for future discounts subject to a minimum current purchase, and other similar offers. Current discount offers, when accepted by our customers, are treated as a reduction to the purchase price of the related transaction, while inducement offers, when accepted by our customers, are treated as a reduction to purchase price based on estimated future redemption rates. Redemption rates are estimated using our historical experience for similar inducement offers. Current discount offers and inducement offers are classified as an offsetting amount in “Net sales.”

Commissions and per-unit fees received from third-party sellers and similar amounts earned through Amazon Enterprise Solutions are recognized when the item is sold by the third-party seller and our collectibility is reasonably assured. When we are responsible for fulfillment-related services, commissions are recognized when risk of loss and title transfer to the customer. We record an allowance for estimated refunds on such commissions using historical experience.

Inventories

Inventories, consisting of products available for sale, are accounted for using the first-in first-out (“FIFO”) method, and are valued at the lower of cost or market value. This valuation requires us to make judgments, based on currently-available information, about the likely method of disposition, such as through sales to individual customers, returns to product vendors, or liquidations, and expected recoverable values of each disposition category. Based on this evaluation, we adjust the carrying amount of our inventories to lower of cost or market value.

We provide fulfillment-related services in connection with certain of our agreements. In those arrangements, as well as other product sales by third parties, the third-party maintains ownership of the related products.

Internal-Use Software and Website Development

Included in fixed assets is the capitalized cost of internal-use software and website development, including software used to upgrade and enhance our websites and processes supporting our business. As required by Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* we capitalize costs incurred during the application development stage of internal-use software and amortize these costs over the estimated useful life of two years. Costs incurred related to design or maintenance of internal-use software are expensed as incurred.

Valuation of Deferred Tax Assets

SFAS 109, *Accounting for Income Taxes,* requires that deferred tax assets be evaluated for future realization and reduced by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets including our recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carry-forward periods available to us for tax reporting purposes, and other relevant factors. In accordance with the provisions of SFAS 109, we allocate our valuation allowance to current and long-term deferred tax assets on a pro-rata basis.

Stock-Based Compensation

In accordance with SFAS 123(R), we measure compensation cost for stock awards at fair value and recognize compensation over the service period for awards expected to vest. The estimation of stock awards that ultimately will vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

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Liquidity and Capital Resources

Net cash flow information is as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,		Twelve Months Ended September 30,	
	2006	2005	2006	2005	2006	2005
Net cash provided by (used in):						
Operating activities	$ 130	$ 153	$ (42)	$ 103	$ 587	$ 661
Investing activities	147	(206)	190	(547)	(39)	(613)
Financing activities	(268)	30	(492)	(217)	(468)	(200)

Our financial focus is on long-term, sustainable growth in free cash flow. Free cash flow, a non-GAAP financial measure, was $366 million for the trailing twelve months ended September 30, 2006, compared to $475 million for the trailing twelve months ended September 30, 2005, a decrease of 23%, primarily driven by our increased expenditure in technology and content. See Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Non-GAAP Financial Measures" for a reconciliation of free cash flow to net cash provided by operating activities. Other items reducing free cash flow for the trailing twelve months ended September 30, 2006 include changes in working capital, the termination of our contract with Toysrus.com LLC and $43 million from excess tax benefits for stock-based compensation now classified as financing cash flows. During Q3 2006, we paid Toysrus.com LLC $13 million previously retained by us against payments otherwise due to them. Free cash flow for the twelve months ended September 30, 2005, was reduced by a $40 million payment for a patent litigation settlement in Q3 2005. Operating cash flows and free cash flow can be volatile and are sensitive to many factors, including changes in working capital and timing of capital expenditures. Working capital at any specific point in time is subject to many variables, including seasonality, inventory management and category expansion, the timing of expense payments and cash receipts, discounts offered by vendors, vendor payment terms, and fluctuations in foreign exchange rates.

Our principal sources of liquidity are cash flows generated from operations and our cash, cash equivalents, and marketable securities balances, which, at fair value, were $1.2 billion and $2.0 billion at September 30, 2006 and December 31, 2005. Amounts held in foreign currencies were $383 million and $905 million at September 30, 2006 and December 31, 2005, and were primarily Euros, British Pounds, and Japanese Yen.

Tax benefits resulting from stock-based compensation deductions in excess of amounts reported for financial reporting purposes were $9 million and $2 million for Q3 2006 and Q3 2005, and $38 million and $4 million for the nine months ended September 30, 2006 and 2005, with such amounts treated as financing cash flows. We expect amounts for 2006 to increase substantially from comparable amounts in 2005. Accordingly, amounts presented for operating cash flows and free cash flow for 2006 will be negatively effected in comparison to prior results; however, the underlying economic substance is not affected by this change in reporting classification.

Cash provided by operating activities was $130 million and $153 million for Q3 2006 and Q3 2005. Cash used in operating activities was $42 million for the nine months ended September 30, 2006, and cash provided by operating activities was $103 million for the nine months ended September 30, 2005. Our operating cash flows result primarily from cash received from our customers, from third-party sellers, and from non-retail activities such as through our co-branded credit card agreements, Amazon Enterprise Solutions, and miscellaneous marketing and promotional agreements, offset by cash payments we make for products and services, employee compensation (less amounts capitalized pursuant to SOP 98-1 that are reflected as cash used in investing activities), payment processing and related transaction costs, operating leases, and interest payments on our long-term debt obligations. Cash received from customers, third-party sellers and non-retail activities generally corresponds to our net sales. Because our customers primarily use credit cards to buy from us, our receivables from customers settle quickly. Cash paid to inventory and transportation suppliers generally corresponds with cost of sales, adjusted for increases or decreases in inventory and payable levels as well as increases or decreases in vendor-related receivables for co-operative marketing, volume rebates, and other incentives. Cash paid to inventory suppliers, totaled $1.5 billion and $1.2 billion in Q3 2006 and Q3 2005, and $4.8 billion and $3.8 billion for the nine months ended September 30, 2006 and 2005. Cash paid to inventory suppliers is also affected by our efforts to add product categories, increase selection of products we offer for sale, improve availability in both existing and new product categories, and take advantage of additional discounts offered to us by suppliers.

Cash provided by (used in) investing activities corresponds with purchases, sales, and maturities of marketable securities, net cash flows from acquisitions, and purchases of fixed assets, including internal-use software and website development costs. Net cash provided by investing activities was $147 million for Q3 2006, and net cash used in investing activities was $206 million for Q3 2005. Net cash provided by investing activities was $190 million for the nine months ended September 30, 2006, and net cash used in investing activities was $547 million for the nine months ended September 30, 2005. Capital expenditures were $62 million and $76 million during Q3 2006 and Q3 2005, and $166 million and $149 million during the nine months ended September 30, 2006 and 2005, with these expenditures reflecting investment in development of new features and product offerings on our websites, as well as investments in fulfillment-related assets and technology infrastructure. Capital expenditures included $28 million and $21 million for internal-use software and website development during Q3 2006 and Q3 2005, and $80 million and $57 million during the nine months ended September 30, 2006 and 2005. Stock-based compensation capitalized for internal-use software and website development costs does not affect cash flows. We purchased certain companies during the nine months ended September 30, 2006 and 2005, resulting in cash payments, net of acquired cash, of $30 million and $24 million. We believe our expenditures for repairs and improvements are sufficient to keep our facilities and equipment in suitable operating condition.

Cash used in financing activities was $268 million during Q3 2006, and cash provided by financing activities was $30 million during Q3 2005. Cash used in financing activities was $492 million and $217 million for the nine months ended September 30, 2006 and 2005. In Q3 2006, we repurchased $252 million of our common stock under the $500 million repurchase program authorized by our Board of Directors (see Item 2 of Part II – “Unregistered Sales of Equity Securities and Use of Proceeds”). In Q1 2006, we repaid €250 million of our 6.875% PEACS for $300 million. In Q1 2005, we repaid €200 million of our 6.875% PEACS for $265 million. Cash inflows from financing activities primarily result from proceeds from exercises of employee stock options, and tax benefits relating to excess stock-based compensation deductions. Cash inflows from proceeds from exercise of employee stock options were $4 million and $21 million for Q3 2006 and Q3 2005, and $17 million and $38 million for the nine months ended September 30, 2006 and 2005. Cash inflows from tax benefits related to stock-based compensation deductions were $9 million and $2 million for Q3 2006 and Q3 2005, and $38 million and $4 million for the nine months ended September 30, 2006 and 2005. Although quarterly activity is subject to variability, we expect cash proceeds from exercises of stock options will decline over time as we continue issuing restricted stock units as our primary vehicle for stock-based awards.

Since our 6.875% PEACS, which are due in 2010, are denominated in Euros, our U.S. Dollar equivalent interest payments and principal obligations fluctuate with the Euro to U.S. Dollar exchange rate. As a result, any fluctuations in the exchange rate will have an effect on our interest expense and, to the extent we make principal payments, the amount of U.S. Dollar equivalents necessary for principal settlement. Additionally, since our interest payable on our 6.875% PEACS is due in Euros, the balance of interest payable is subject to gains or losses on currency movements until the date of the interest payment. Gains or losses on the remeasurement of our Euro-denominated interest payable are classified as “Other income, net” on our consolidated statements of operations.

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The following summarizes our principal contractual commitments as of September 30, 2006 (in millions):

	Three Months Ending December 31, 2006	Year Ended December 31, 2007	2008	2009	2010	Thereafter	Total
Operating and capital commitments:							
Debt principal and other (1)	$ 11	$ 74	$ 9	$ 910	$ 344	$ 24	$ 1,372
Debt interest (1)	1	66	65	43	21	—	196
Operating leases (2)(3)	33	119	107	89	70	224	642
Purchase obligations (4)	837	11	9	9	9	9	884
Total commitments	$ 882	$ 270	$ 190	$ 1,051	$ 444	$ 257	$ 3,094

(1) At September 30, 2006, the Euro to U.S. Dollar exchange rate was 1.2674. Due to changes in the Euro/U.S. Dollar exchange ratio, our remaining principal debt obligation under this instrument since issuance in February 2000 has increased by $68 million as of September 30, 2006.

(2) Pursuant to SFAS 13, *Accounting for Leases*, lease agreements are categorized at their inception as either operating or capital leases depending on certain defined criteria. Although operating leases represent obligations for us, pursuant to SFAS 13 they are not reflected on our consolidated balance sheets. Of the $642 million remaining obligations under operating leases, $40 million relates to equipment operating leases. If we had applied to our equipment operating leases the same convention used for capital leases, which, however, would not be in accordance with GAAP, we would have recorded approximately $35 million of additional obligations on our consolidated balance sheets.

(3) Includes $8 million related to restructuring-related leases and other commitments, consisting of $4 million due within 12 months and included in “Accrued expenses and other current liabilities,” and $4 million due after 12 months and included in “Long-term debt and other” on our consolidated balance sheets. These amounts are net of anticipated sublease income of $4 million.

(4) Consists of legally-binding commitments to purchase inventory and significant non-inventory commitments.

Pledged Securities

We are required to support certain letters of credit, debt, and real estate leases by pledging or otherwise restricting cash and marketable securities. We classify marketable securities, where a restriction to use exists for a period of twelve months or longer, as non-current “Other assets” on our consolidated balance sheets. The balance of pledged securities at September 30, 2006 consisted of $5 million in “Cash and cash equivalents”, $67 million in “Marketable securities” and $83 million in “Other assets”. The amount required to be pledged for certain real estate lease agreements changes over the life of our leases, and with fluctuations in our market capitalization and our credit rating. Information about collateral required to be pledged under these agreements is as follows:

	Standby and Trade Letters of Credit (1)	Debt (2) (in millions)	Real Estate Leases (3)	Total
Balance at December 31, 2005	$ 59	$ 14	$ 18	$ 91
Net change in collateral pledged	21	41	2	64
Balance at September 30, 2006	$ 80	$ 55	$ 20	$ 155

(1) Pursuant to available standby and trade letter-of-credit facilities totaling $158 million.

(2) Represents collateral for certain debt related to our international operations.

(3) At September 30, 2006, our market capitalization was $13.2 billion. The required amount of collateral to be pledged will increase by $6 million if our market capitalization is equal to or below $13 billion and decrease by $5 million if our market capitalization exceeds $18 billion.

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We believe that current cash, cash equivalents, and marketable securities balances will be sufficient to meet our anticipated operating cash needs for at least the next 12 months. However, any projections of future cash needs and cash flows are subject to substantial uncertainty. See Item 1A of Part II, "Risk Factors". We continually evaluate opportunities to sell additional equity or debt securities, obtain credit facilities from lenders, repurchase common stock, pay dividends, or repurchase, refinance, or otherwise restructure our long-term debt for strategic reasons or to further strengthen our financial position. The sale of additional equity or convertible debt securities would likely be dilutive to our shareholders. In addition, we will, from time to time, consider the acquisition of, or investment in, complementary businesses, products, services, and technologies, which might affect our liquidity requirements or cause us to issue additional equity or debt securities. There can be no assurance that additional lines-of-credit or financing instruments will be available in amounts or on terms acceptable to us, if at all.

Results of Operations

We have organized our operations into two principal segments: North America and International. We present our segment information along the same lines that our chief executive reviews our operating results in assessing performance and allocating resources.

Net Sales and Gross Profit

Net sales information is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)		(in millions)	
Net Sales:				
North America	$1,257	$1,041	$3,661	$3,028
International	1,050	817	3,064	2,485
Consolidated	$2,307	$1,858	$6,725	$5,513
Year-over-year Percentage Growth:				
North America	21%	28%	21%	23%
International	29	26	23	29
Consolidated	24	27	22	26
Year-over-year Percentage Growth, excluding effect of exchange rates:				
North America	21%	27%	21%	23%
International	26	28	27	27
Consolidated	23	28	24	25
Net Sales Mix:				
North America	54%	56%	54%	55%
International	46	44	46	45
Consolidated	100%	100%	100%	100%

Revenue increased 24% in Q3 2006 and 22% for the nine months ended September 30, 2006. Changes in currency exchange rates positively affected net sales by $20 million for Q3 2006, and negatively affected net sales by $98 million for the nine months ended September 30, 2006. For a discussion of the effect on revenue growth by changes in exchange rates, see "Effect of Exchange Rates" below. The Q3 2005 and nine months ended September 30, 2005 growth rates include the effects of the Q3 2005 release of *Harry Potter and the Half-Blood Prince*, of which we sold over 1.6 million copies during Q3 2005.

The North America revenue growth rate was 21% for Q3 2006 and the nine months ended September 30, 2006. This revenue growth primarily reflects increases in unit sales driven by continued improvements in customer experience, including Amazon Prime, reducing prices for our customers, free shipping offers, and increased selection in our product categories.

The International revenue growth rate was 29% for Q3 2006, and 23% for the nine months ended September 30, 2006. This revenue growth primarily reflects increases in unit sales driven by continued improvements in customer experience, including reducing prices for our customers, free shipping offers, and increased selection in our product categories. Additionally, changes in exchange rates positively affected International net sales by $18 million for Q3 2006, and negatively affected International net sales by $103 million for the nine months ended September 30, 2006.

Gross profit information is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)		(in millions)	
Gross Profit:				
North America	$ 343	$ 292	$ 993	$ 849
International	206	171	613	523
Consolidated	$ 549	$ 463	$1,606	$1,372
Gross Profit Growth Rate:				
North America	17%	31%	17%	27%
International	21	29	17	35
Consolidated	18	30	17	30
Gross Margin:				
North America	27.3%	28.1%	27.1%	28.1%
International	19.6	20.9	20.0	21.0
Consolidated	23.8	24.9	23.9	24.9

The increase in gross profit in absolute terms during Q3 2006 and the nine months ended September 30, 2006 compared with comparable prior year periods corresponds with increases in sales, offset by lower prices for customers and our free shipping offers. Generally, our gross margins fluctuate based on several factors, including our product, service, and geographic mix of sales; sales volumes by third-party sellers; changes in vendor pricing, including the extent to which we receive discounts and allowances; lowering prices for customers, including from competitive pricing decisions; improvements in product sourcing and inventory management; and the extent to which our customers accept our free shipping and membership offers. Such free shipping and membership offers reduce shipping revenue and reduce our gross margins on retail sales. Amazon Prime, introduced in Q1 2005, is a premium membership program in which members receive free two-day shipping and discounted overnight shipping. We offer promotions, such as free membership trials, for Amazon Prime, and we expect to continue to offer these promotions in the future. We view our shipping offers as an effective worldwide marketing tool and intend to continue offering them indefinitely.

Sales of products by third-party sellers on our websites represented 30% of unit sales for each of Q3 2006 and Q3 2005, and 29% for each of the nine months ended September 30, 2006 and 2005. Since revenues from these sales are recorded as a net amount, they generally result in lower revenues but higher gross margin per unit. Since we focus on profit dollars rather than margins, we are largely neutral on whether an item is sold by us or by a third party.

Gross profit growth is also affected by changes in exchange rates — see “Effect of Exchange Rates” below.

North America segment gross margins declined by 78 basis points and 92 basis points in Q3 2006 and the nine months ended September 30, 2006 from the comparable periods in 2005. International segment gross margins declined by 130 basis points and 104 basis points in Q3 2006 and the nine months ended September 30, 2006 from the comparable periods in 2005. These declines primarily resulted from our efforts to continue reducing prices for customers and changes in the mix of product sales.

Supplemental Information

Supplemental information about shipping results is as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Shipping Activity:				
Shipping revenue (1)(2)	$ 118	$ 112	$ 375	$ 323
Outbound shipping costs	(182)	(159)	(567)	(471)
Net shipping cost	$ (64)	$ (47)	$(192)	$(148)
Year-over-year Percentage Growth:				
Shipping revenue	5%	30%	16%	22%
Outbound shipping costs	14	25	20	23
Net shipping cost	36	15	30	25
Percent of Net Sales:				
Shipping revenue	5.1%	6.0%	5.6%	5.9%
Outbound shipping costs	(7.9)	(8.5)	(8.4)	(8.6)
Net shipping cost	(2.8)%	(2.5)%	(2.8)%	(2.7)%

(1) Outbound shipping charges to customers do not include amounts earned on shipping by third-party sellers where we do not provide the fulfillment service.

(2) Includes amounts earned from Amazon Prime membership program.

One way we offer lower prices is through free-shipping offers that result in a net cost to us in delivering products, as well as through membership in Amazon Prime. To the extent our customers use our free shipping offers at an increasing rate, including memberships in Amazon Prime, our net cost of shipping will increase. Our net shipping cost results primarily from our free shipping offers and Amazon Prime. We seek to partially mitigate the costs of lowering prices over time through achieving higher sales volumes, negotiating better terms with our suppliers, and achieving better operating efficiencies. In addition, the costs of lowering prices over time may be partially mitigated to the extent product sales by third-party sellers continue to increase.

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Supplemental information about our net sales is as follows:

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
	(in millions)		(in millions)	
Net Sales:				
North America				
Media	$ 785	$ 684	$2,330	$2,015
Electronics and other general merchandise	409	304	1,148	863
Other (1)	63	53	183	150
Total North America	$1,257	$1,041	$3,661	$3,028
International				
Media	$ 757	$ 629	$2,237	$1,917
Electronics and other general merchandise	290	187	815	565
Other (1)	3	1	12	3
Total International	$1,050	$ 817	$3,064	$2,485
Consolidated				
Media	$1,542	$1,313	$4,567	$3,932
Electronics and other general merchandise	699	491	1,963	1,428
Other (1)	66	54	195	153
Total consolidated	$2,307	$1,858	$6,725	$5,513
Year-over-year Percentage Growth:				
North America				
Media (2)	15%	21%	16%	18%
Electronics and other general merchandise	35	33	33	27
Other	17	122	22	108
Total North America	21	28	21	23
International				
Media (2)	20%	19%	17%	20%
Electronics and other general merchandise	55	62	44	76
Other	144	177	286	85
Total International	29	26	23	29
Consolidated				
Media (2)	17%	20%	16%	19%
Electronics and other general merchandise	43	43	38	43
Other	20	123	27	107
Total consolidated	24	27	22	26
Year-over-year Percentage Growth:				
Excluding the effect of exchange rates				
International				
Media (2)	19%	20%	21%	18%
Electronics and other general merchandise	51	64	48	72
Other	135	178	296	82
Total International	26	28	27	27
Consolidated				
Media (2)	17%	21%	18%	18%
Electronics and other general merchandise	41	43	39	42
Other	20	123	27	107
Total consolidated	23	28	24	25
Consolidated Net Sales Mix:				
Media	67%	71%	68%	71%
Electronics and other general merchandise	30	26	29	26
Other	3	3	3	3
Total consolidated	100%	100%	100%	100%

(1) Includes non-retail activities, such as Amazon Enterprise Solutions, our co-branded credit card agreements, and miscellaneous marketing and promotional activities.
(2) Year-over-year percentage growth comparisons are affected by the Q3 2005 release of *Harry Potter and the Half-Blood Prince*.

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Operating Expenses

Information about operating expenses with and without stock-based compensation was as follows (in millions):

	Three Months Ended September 30, 2006			Three Months Ended September 30, 2005		
	As Reported	Stock-Based Compensation	Net	As Reported	Stock-Based Compensation	Net
Operating Expenses:						
Fulfillment	$ 217	$ (8)	$ 209	$ 171	$ (5)	$ 166
Marketing	64	(1)	63	44	(2)	42
Technology and content	172	(16)	156	121	(13)	108
General and administrative	54	(5)	49	32	(6)	26
Other operating expense	2	—	2	40	—	40
Total operating expenses	$ 509	$ (30)	$ 479	$ 408	$ (26)	$ 382
Year-over-year Percentage Growth:						
Fulfillment	27%		26%	24%		23%
Marketing	45		49	28		23
Technology and content	42		45	74		66
General and administrative	69		87	12		1
Percent of Net Sales:						
Fulfillment	9.4%		9.1%	9.2%		8.9%
Marketing	2.8		2.7	2.4		2.3
Technology and content	7.4		6.8	6.5		5.8
General and administrative	2.4		2.1	1.7		1.4

	Nine Months Ended September 30, 2006			Nine Months Ended September 30, 2005		
	As Reported	Stock-Based Compensation	Net	As Reported	Stock-Based Compensation	Net
Operating Expenses:						
Fulfillment	$ 599	$ (18)	$ 581	$ 495	$ (13)	$ 482
Marketing	171	(3)	168	131	(5)	126
Technology and content	485	(38)	447	319	(36)	283
General and administrative	150	(12)	138	117	(17)	100
Other operating expense	9	—	9	43	—	43
Total operating expenses	$ 1,414	$ (71)	$1,343	$ 1,105	$ (71)	$1,034
Year-over-year Percentage Growth:						
Fulfillment	21%		21%	26%		25%
Marketing	31		34	27		25
Technology and content	52		58	60		59
General and administrative	28		37	31		25
Percent of Net Sales:						
Fulfillment	8.9%		8.6%	9.0%		8.7%
Marketing	2.5		2.5	2.4		2.3
Technology and content	7.2		6.6	5.8		5.1
General and administrative	2.2		2.1	2.1		1.8

Operating expenses without stock-based compensation are non-GAAP financial measures. See Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Non-GAAP Financial Measures" and Item 1 of Part I, "Financial Statements — Note 1 — Accounting Policies — Stock-Based Compensation."

Fulfillment

The increase in fulfillment costs in absolute dollars in Q3 2006 and the nine months ended September 30, 2006, compared with comparable prior year periods, relates to costs from expanding fulfillment capacity and variable costs. Variable costs correspond with sales volume and inventory levels, our mix of product sales, and payment processing and related transaction costs, including mix of payment methods and costs from our guarantee for certain third-party seller transactions. Fulfillment includes stock-based compensation of $8 million and $5 million for Q3 2006 and Q3 2005, and $18 million and $13 million for the nine months ended September 30, 2006 and 2005.

Fulfillment costs as a percentage of net sales may vary due to several factors, such as payment processing and related transaction costs, including those from our guarantee for certain third-party seller transactions, our level of productivity and accuracy, changes in volume of units received and fulfilled, the extent we utilize fulfillment services provided by third parties, and our ability to reduce customer service contacts per unit by implementing improvements in our operations and enhancements to our customer self-service features. The mix of product sales affects fulfillment costs per shipment based on variations in shape and weight of products we sell. Additionally, because payment processing costs associated with third-party seller transactions are based on the gross purchase price of underlying transactions, and payment processing and related transaction costs and our A to Z Guarantee costs associated with these transactions are higher as a percentage of revenue versus our retail sales, our third-party sales have higher fulfillment costs as a percent of net sales.

We expanded our fulfillment capacity during the nine months ended September 30, 2006 and throughout 2005 through gains in efficiencies as well as increases in leased warehouse space. Our worldwide fulfillment capacity expansion in 2006, which will add less space than 2005, is designed to accommodate greater selection and meet anticipated shipment volumes from sales of our own products as well as sales by third parties for which we provide the fulfillment.

Marketing

We direct customers to our websites primarily through a number of targeted online marketing channels, such as our Associates and Syndicated Stores programs, sponsored search, portal advertising, e-mail campaigns, and other initiatives. Our marketing expenses are largely variable, based on growth in sales and changes in rates. To the extent there is increased or decreased competition for these traffic sources, or to the extent our mix of these channels shifts, we would expect to see a corresponding change in our marketing expense or its effect.

Marketing costs increased in absolute dollars in Q3 2006 and the nine months ended September 30, 2006, compared to comparable prior year periods, due to increased spending in variable online marketing channels, such as our Associates program, sponsored search, and other variable marketing initiatives. Marketing includes stock-based compensation of $1 million and $2 million for Q3 2006 and Q3 2005, and $3 million and $5 million for the nine months ended September 30, 2006 and 2005.

While costs associated with free shipping are not included in marketing expense, we view free shipping offers as an effective worldwide marketing tool, and intend to continue offering them indefinitely.

Technology and Content

In 2005, we added a significant number of computer scientists, software engineers, and employees involved in editorial content, buying, merchandising, and systems support. We are investing in several areas of technology including seller platforms, web services, and digital initiatives. In addition, we increased spending on our technology infrastructure so that we can continue to enhance the customer experience and improve our process efficiency. We expect the year-over-year percentage growth in technology and content, excluding stock-based compensation, to continue to decrease in Q4 2006. Technology and content includes stock-based compensation of $16 million and $13 million for Q3 2006 and Q3 2005, and $38 million and $36 million for the nine months ended September 30, 2006 and 2005.

During Q3 2006 and Q3 2005, we capitalized $34 million (including $5 million of stock-based compensation) and $25 million (including $3 million of stock-based compensation) of costs associated with internal-use software and website development. For the nine months ended September 30, 2006 and 2005, we capitalized $92 million (including $12 million of stock-based compensation) and $65 million (including $8 million of stock- based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $23 million and $14 million for Q3 2006 and Q3 2005, and $61 million and $35 million for the nine months ended September 30, 2006 and 2005.

A significant majority of our technology costs are incurred in the U.S. and are allocated to our North America segment.

General and Administrative

The increase in general and administrative costs in Q3 2006 and the nine months ended September 30, 2006, compared to the comparable prior year periods, is primarily due to increases in payroll and related expenses. Q3 2005 also included a $12 million credit for actual and expected reimbursement by an insurer of certain legal costs previously incurred by us. General and administrative includes stock-based compensation of $5 million and $6 million for Q3 2006 and Q3 2005, and $12 million and $17 million for the nine months ended September 30, 2006 and 2005.

Stock-Based Compensation

Stock-based compensation was $30 million and $26 million during Q3 2006 and Q3 2005, with the increase primarily due to increased restricted stock unit grants generally corresponding with an increase in employees. Stock-based compensation was $71 million for each of the nine months ended September 30, 2006 and 2005. In Q1 2006 we recorded a $13 million benefit, $8 million net of tax, or $0.02 per diluted share, representing the cumulative effect of increasing our estimated rate of stock award forfeitures. For the nine months ended September 30, 2006, this benefit was offset by increased restricted stock unit grants generally corresponding with an increase in employees.

The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

In addition, the adoption of SFAS 123(R) in Q1 2005 resulted in a cumulative benefit from accounting change of $26 million, which reflects the net cumulative impact of estimating future forfeitures in the determination of period expense, rather than recording forfeitures when they occur as previously permitted.

Net Interest Expense

The primary component of our net interest expense is the interest we incur on our long-term debt instruments, including $900 million principal balance of our 4.75% Convertible Subordinated Notes and €240 million ($304 million based on the exchange rate at September 30, 2006) of our 6.875% PEACS at September 30, 2006. Interest expense was $21 million and $22 million in Q3 2006 and Q3 2005, and $58 million and $70 million for the nine months ended September 30, 2006 and 2005, with declines primarily relating to principal repayments of our long-term debt.

At September 30, 2006, our total long-term debt was $1.3 billion compared to $1.5 billion at December 31, 2005. See Item 1 of Part I, "Financial Statements — Note 3 — Long-Term Debt and Other."

We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market mutual funds. Our interest income corresponds with the average balance of invested funds and the prevailing rates we are earning on them, which vary depending on the geographies in which they are invested.

Remeasurements and Other

Remeasurements and other consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)		(in millions)	
Foreign-currency gain (loss) on remeasurement of 6.875% PEACS	$ 3	$ 4	$ (24)	$ 81
Loss on redemption of long-term debt	—	—	(6)	(4)
Foreign-currency effect on intercompany balances	(4)	(2)	37	(41)
Other	2	4	3	2
Total remeasurements and other	$ 1	$ 6	$ 10	$ 38

Income Taxes

Our tax provision for interim periods is determined using an estimate of our annual effective tax rate. There is a potential for significant volatility of our 2006 effective tax rate due to several factors, including from variability in accurately predicting our taxable income and the taxable jurisdictions to which it relates. The effective tax rates in Q3 2006 and for the nine months ended September 30, 2006 were higher than the 35% statutory rate, resulting from steps we initiated to establish our European headquarters in Luxembourg, which we expect will benefit our effective tax rate over time. Associated with the establishment of our European headquarters, we transferred certain of our operating assets in 2005 and 2006, from the U.S. to international locations. These transfers resulted in taxable income and an increase in our effective tax rate. We expect the transfers will result in an effective tax rate for financial reporting purposes higher than the statutory rate throughout 2006. Since we have deferred tax assets related to our NOLs, these asset transfers are not expected to have a significant impact on our cash taxes paid in 2006, which we expect to be approximately $25 million. We endeavor to optimize our global taxes on a cash basis, rather than on a financial reporting basis. Cash paid for income taxes was $5 million and $6 million in Q3 2006 and Q3 2005, and $13 million and $11 million for the nine months ended September 30, 2006 and 2005.

Net Income

Net income was $19 million and $30 million for Q3 2006 and Q3 2005, and $93 million and $160 million for the nine months ended September 30, 2006 and 2005. The year-over-year changes include the effect of a patent lawsuit settlement, which resulted in a one-time payment of $40 million in Q3 2005. Additionally, a benefit of $26 million was included in net income for the nine months ended September 30, 2005, representing the cumulative effect of adopting SFAS 123(R).

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Effect of Exchange Rates

The effect on our consolidated statements of operations from changes in exchange rates versus the U.S. Dollar is as follows:

	Three Months Ended September 30,					
	2006			2005		
	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported
	(in millions, except per share amounts)					
Net sales	$ 2,287	$ 20	$ 2,307	$ 1,865	$ (7)	$ 1,858
Gross profit	545	4	549	464	(1)	463
Operating expenses	506	3	509	408	—	408
Income from operations	39	1	40	56	(1)	55
Net interest expense and other	3	—	3	10	—	10
Remeasurements and other income (3)	2	(1)	1	4	2	6
Net income	19	—	19	29	1	30
Diluted earnings per share	$ 0.05	$ —	$ 0.05	$ 0.07	$ —	$ 0.07

	Nine Months Ended September 30,					
	2006			2005		
	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported
	(in millions, except per share amounts)					
Net sales	$ 6,823	$ (98)	$ 6,725	$ 5,465	$ 48	$ 5,513
Gross profit	1,626	(20)	1,606	1,362	10	1,372
Operating expenses	1,424	(10)	1,414	1,098	7	1,105
Income from operations	202	(10)	192	263	4	267
Net interest expense and other	14	(1)	13	41	(3)	38
Remeasurements and other income (expense) (3)	(2)	12	10	(1)	39	38
Net income	92	1	93	137	23	160
Diluted earnings per share	$ 0.22	$ —	$ 0.22	$ 0.32	$ 0.06	$ 0.38

(1) Represents the outcome that would have resulted had exchange rates in the current period been the same as those in effect in the comparable prior year period for operating results, and if we did not incur the variability associated with remeasurements for our 6.875% PEACS and intercompany balances.

(2) Represents the increase or decrease in reported amounts resulting from changes in exchange rates from those in effect in the comparable prior year period for operating results, and if we did not incur the variability associated with remeasurements for our 6.875% PEACS and intercompany balances.

(3) Includes foreign-currency gains (losses) on remeasurement of 6.875% PEACS and intercompany balances, and realized currency-related gains associated with sales of Euro-denominated investments held by a U.S. subsidiary. See Item 1 of Part I, "Financial Statements — Note 7 — Remeasurements and Other."

Non-GAAP Financial Measures

Regulation G, *Conditions for Use of Non-GAAP Financial Measures*, and other SEC regulations define and prescribe the conditions for use of certain non-GAAP financial information. Our measure of "Free cash flow" meets the definition of a non-GAAP financial measure. Free cash flow is used in addition to and in conjunction with results presented in accordance with GAAP and free cash flow should not be relied upon to the exclusion of GAAP financial measures. Free cash flow reflects an additional way of viewing our liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our cash flows. Management strongly encourages shareholders to review our financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

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Free cash flow, which we reconcile to "Net cash provided by operating activities," is cash flow from operations reduced by "Purchases of fixed assets, including internal-use software and website development." We use free cash flow, and ratios based on it, to conduct and evaluate our business because, although it is similar to cash flow from operations, we believe it is a more conservative measure of cash flows since purchases of fixed assets are a necessary component of ongoing operations. In limited circumstances in which proceeds from sales of fixed assets exceed purchases, free cash flow would exceed cash flow from operations. However, since we do not anticipate being a net seller of fixed assets, we expect free cash flow to be less than operating cash flows.

Free cash flow has limitations due to the fact that it does not represent the residual cash flow available for discretionary expenditures. For example, free cash flow does not incorporate payments made on capital lease obligations or cash payments for business acquisitions. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows.

The following is a reconciliation of free cash flow to the most comparable GAAP measure, "Net cash provided by operating activities" for the trailing twelve months ended September 30, 2006 and 2005 (in millions):

	Twelve Months Ended September 30,	
	2006	2005
Net cash provided by operating activities	$ 587	$ 661
Purchases of fixed assets, including internal-use software and website development	(221)	(186)
Free cash flow	$ 366	$ 475
Net cash used in investing activities	$ (39)	$(613)
Net cash used in financing activities	$(468)	$(200)

In addition, we provide operating expenses with and without stock-based compensation. We provide this information to show the impact of stock-based compensation, which is non-cash and excluded from our internal operating plans and measurement of financial performance (although we consider the dilutive impact to our shareholders when awarding stock-based compensation and value such awards accordingly). In addition, unlike other centrally-incurred operating costs, stock-based compensation is not allocated to segment results and therefore excluding it from operating expense is consistent with our segment presentation in our footnotes to the consolidated financial statements.

Operating expenses without stock-based compensation have limitations due to the fact that they do not include all expenses primarily related to our workforce. More specifically, if we did not pay out a portion of our compensation in the form of stock-based compensation, our cash salary expense included in the "Fulfillment", "Technology and content", "Marketing", and "General and administrative" line items would be higher. We compensate for this limitation by providing supplemental information about outstanding stock-based awards in the footnotes to our financial statements. Stock-based compensation programs are an important element of the Company's compensation structure and all forms of stock-based awards are valued and included as appropriate in results of operations.

Guidance

We provided guidance on October 24, 2006, in our earnings release furnished on Form 8-K as follows:

Fourth Quarter 2006 Guidance

- Net sales are expected to be between $3.625 billion and $3.950 billion, or to grow between 22% and 33% compared with fourth quarter 2005.

- Operating income is expected to be between $145 million and $235 million, or between (12%) decline and 43% growth, compared with fourth quarter 2005. This guidance includes $35 million for stock-based compensation and amortization of intangible assets, and it assumes, among other things, that no additional intangible assets are recorded and that there are no further revisions to stock-based compensation estimates.

Full Year 2006 Guidance

- Net sales are expected to be between $10.350 billion and $10.675 billion, or to grow between 22% and 26% compared with 2005.
- Operating income is expected to be between $339 million and $429 million, or between (22%) decline and (1%) decline, compared with 2005. This guidance includes $113 million for stock-based compensation and amortization of intangible assets, and it assumes, among other things, that no additional intangible assets are recorded and that there are no further revisions to stock-based compensation estimates.

These projections are subject to substantial uncertainty. See Item 1A of Part II, "Risk Factors."

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

We are exposed to market risk for the effect of interest rate changes, foreign currency fluctuations, and changes in the market values of our investments.

Information relating to quantitative and qualitative market risks is set forth below and in Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and our long-term debt. All of our cash equivalent and marketable fixed income securities are designated as available-for-sale and, accordingly, are presented at fair value on our consolidated balance sheets. We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market mutual funds. Fixed rate securities may have their fair market value adversely affected due to a rise in interest rates, and we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates.

At September 30, 2006, we had long-term debt of $1.3 billion primarily associated with our 4.75% Convertible Subordinated Notes and 6.875% PEACS, which are due in 2009 and 2010. The market value of our long-term debt will fluctuate with movements of interest rates, generally increasing in periods of declining rates of interest and declining in periods of increasing rates of interest. Based upon quoted market prices, the fair value of the 4.75% Convertible Subordinated Notes (outstanding principal of $900 million) was $875 million and $868 million at September 30, 2006 and December 31, 2005. The fair value of the 6.875% PEACS was $308 million at September 30, 2006 (outstanding principal of €240 million), and $586 million at December 31, 2005 (outstanding principal of €490 million).

Foreign Exchange Risk

During each of Q3 2006 and the nine months ended September 30, 2006, net sales from our International segment (consisting of *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr*, *www.amazon.co.jp*, and *www.joyo.com*) accounted for 46% of our consolidated revenues. Net sales and related expenses generated from these websites, as well as those relating to *www.amazon.ca* (which is included in our North America segment), are denominated in the functional currencies of the corresponding websites and primarily include British Pounds, Euros, and Japanese Yen. The functional currency of our subsidiaries that either operate or support these websites is the same as the corresponding local currency. The results of operations of, and certain of our intercompany balances associated with, our internationally-focused websites are exposed to foreign exchange rate fluctuations. Upon consolidation, as exchange rates vary, net sales and other operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. For example, as a result of fluctuations in foreign exchange rates throughout the period compared to rates in effect the prior year, net sales in Q3 2006 increased by $20 million.

We have foreign exchange risk related to foreign-denominated cash, cash equivalents, and marketable securities ("foreign funds"). Based on the balance of foreign funds at September 30, 2006 of $383 million, an assumed 5%, 10%, and 20% strengthening of the U.S. Dollar in relation to these foreign currencies would result in fair value declines of $20 million, $40 million, or $75 million. All investments are classified as "available for sale," as defined by SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*. Fluctuations in fair value are recorded in "Accumulated other comprehensive income," a separate component of Stockholders' Equity.

We have foreign exchange risk related to our intercompany balances denominated in foreign currency. Based on the intercompany balances at September 30, 2006 of $427 million, an assumed 5%, 10%, and 20% strengthening of the U.S. Dollar in relation to these foreign currencies would result in losses of $20 million, $45 million, and $90 million, recorded to "Remeasurements and other."

We have foreign exchange risk related to our 6.875% PEACS, which have an outstanding principal balance at September 30, 2006 of €240 million ($304 million, based on the exchange rate as of September 30, 2006). Due to fluctuations in the Euro/U.S. Dollar exchange ratio, which we cannot predict, our remaining principal debt obligation under the 6.875% PEACS since issuance in February 2000 has increased by $68 million as of September 30, 2006. Based on the outstanding 6.875% PEACS' principal balance, an assumed 5%, 10%, and 20% weakening of the U.S. Dollar in relation to the Euro would result in additional losses of approximately $15 million, $30 million, or $60 million, recorded to "Remeasurements and other." Additionally, we have not hedged our interest payments under our 6.875% PEACS to protect against exchange rate fluctuations. Assuming the U.S. Dollar weakens against the Euro by 5%, 10%, and 20%, we would incur $1 million, $2 million, or $4 million additional annual interest expense due solely to fluctuations in foreign exchange.

See Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Effect of Exchange Rates" for additional information on the effect on reported results of changes in exchange rates.

Investment Risk

As of September 30, 2006, our recorded basis in equity securities (including both publicly-traded and private companies) was $15 million, including $4 million classified as "Marketable securities," and $8 million classified as "Other assets." We regularly review the carrying value of our investments and identify and record losses when events and circumstances indicate that declines in the fair value of such assets below our accounting basis are other-than-temporary. The fair values of our investments are subject to significant fluctuations due to volatility of the stock market in general, Company-specific circumstances, and changes in general economic conditions. Based on the fair value of the publicly-traded equity securities we held at September 30, 2006 of $54 million (recorded basis of $9 million), an assumed 15%, 30%, and 50% adverse change to market prices of these securities would result in a corresponding decline in total fair value of approximately $8 million, $16 million, or $27 million.

Item 4. ***Controls and Procedures***

We carried out an evaluation required by the Securities and Exchange Act of 1934 (the "1934 Act"), under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the 1934 Act, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

During the most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management does not expect that our disclosure controls and procedures will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

See Item 1 of Part I, "Financial Statements — Note 4 — Commitments and Contingencies."

Item 1A. *Risk Factors*

The following risk factors and other information included in this Quarterly Report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected.

We Face Intense Competition

The market segments in which we compete are rapidly evolving and intensely competitive, and we have many competitors in different industries, including both the retail and e-commerce services industries.

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 policies. Competitors in both the retail and e-commerce services industries also may be able to devote more resources to technology development, fulfillment, and marketing than we do.

Competition in the e-commerce channel may intensify. Other companies in the retail and e-commerce service industries may enter into business combinations or alliances that strengthen their competitive positions. As various Internet market segments obtain large, loyal customer bases, participants in those segments may expand into the market segments in which we operate. In addition, new and expanded Web technologies, including search, web services, and digital, may further intensify the competitive nature of online retail and e-commerce services. The nature of the Internet as an electronic marketplace facilitates competitive entry and comparison shopping and renders it inherently more competitive than conventional retailing formats. This increased competition may reduce our sales, operating profits, or both.

Our Expansion Places a Significant Strain on our Management, Operational, Financial and Other Resources

We are rapidly and significantly expanding our operations both domestically and internationally and will continue to expand further to pursue growth of our product and service offerings and customer base. Such expansion increases the complexity of our business and places a significant strain on our management, operations, technical performance, financial resources, and internal financial control and reporting functions, and there can be no assurance that we will be able to manage it effectively. Our current and planned personnel, systems, procedures, and controls may not be adequate to support and effectively manage our future operations, especially as we employ personnel in multiple geographic locations. We may not be able to hire, train, retain, motivate, and manage required personnel, which may limit our growth. If any of this were to occur, it could damage our reputation, limit our growth, negatively affect our operating results and harm our business.

Our Expansion into New Product Areas and Geographic Regions Subjects Us to Business and Competitive Risks

We do not expect to benefit in our newer market segments, whether products, services or new geographic areas, from the first-to-market advantage that we experienced in the U.S. online book channel. Our gross profits in our newer business activities may be lower than in our older business activities. In addition, we may have limited or no experience in new product and service activities and new geographic areas, and our customers may not favorably receive our new businesses. Our newer market segments may present special technology challenges that we have not faced before. To the extent we pursue commercial agreements, acquisitions and/or strategic alliances to facilitate new product or service activities or geographic expansion, the agreements, acquisitions and/or alliances may not be successful. If any of this were to occur, it could damage our reputation, limit our growth, negatively affect our operating results and harm our business.

We May Experience Significant Fluctuations in Our Operating Results and Rate of Growth

Due to our limited operating history, our evolving business model, and the unpredictability of our industry, we may not be able to accurately forecast our rate of growth. We base our current and future expense levels and our investment plans on estimates of future net sales and rate of growth. A significant portion of our expenses and investments is fixed, and we may not be able to adjust our spending quickly enough if our net sales fall short of our expectations.

Our revenue and operating profit growth depends on the continued growth of demand for the products and services offered by us or our sellers, and our business is affected by general economic and business conditions throughout the world. A softening of demand, whether caused by changes in consumer preferences or a weakening of the U.S. or global economies, may result in decreased revenue or growth. Terrorist attacks and armed hostilities create economic and consumer uncertainty that could adversely affect our revenue or growth. Such events could create delays in, and increase the cost of, product shipments, which may decrease demand. Revenue growth may not be sustainable and our company-wide percentage growth rate may decrease in the future.

Our net sales and operating results will also fluctuate for many other reasons, including:

- our ability to retain and increase sales to existing customers, attract new customers, and satisfy our customers' demands;
- our ability to expand our network of sellers, and to enter into, maintain, renew, and amend on favorable terms our commercial agreements and strategic alliances;
- foreign exchange rate fluctuations, particularly as international sales become an increasingly larger contributor to our revenues;
- our ability to acquire merchandise, manage inventory, and fulfill orders;
- the introduction by our current or future competitors of websites, products, services, price decreases, or improvements;
- changes in usage of the Internet and e-commerce, including in non-U.S. markets;
- timing, effectiveness, and costs of upgrades and developments in our systems and infrastructure;
- the effects of commercial agreements and strategic alliances and our ability to successfully implement the underlying relationships and integrate them into our business;
- the effects of acquisitions, and other business combinations and our ability to successfully integrate them into our business;
- the success of our geographic and product line expansions;
- the outcomes of legal proceedings and claims;
- technical difficulties, system downtime, or interruptions;
- variations in the mix of products and services we sell;
- variations in our level of merchandise and vendor returns;

- disruptions in service by shipping carriers;
- the extent to which we offer free shipping, continue to reduce product prices worldwide, and provide additional benefits to our customers which reduce our gross or operating profits;
- the extent to which we invest in technology and content, fulfillment, marketing and other expense categories;
- the extent to which we provide for and pay taxes;
- increases in the prices of fuel and gasoline, which are used in the transportation of packages, as well as increases in the prices of other energy products, primarily natural gas and electricity, and commodities like paper and packing supplies, all of which are used in our operating facilities;
- the extent to which operators of the networks between our customers and our websites successfully charge fees to grant our customers unimpaired and unconstrained access to our online services; and
- the extent to which overall Internet use is affected by spyware, viruses, and “phishing,” spoofing and other spam emails directed at Internet users, viruses and “denial of service” attacks directed at Internet companies and service providers, and other events.

Finally, both seasonal fluctuations in Internet usage and traditional retail seasonality are likely to affect our business. Internet usage generally slows during the summer months, and sales in almost all of our product groups, particularly toys and electronics, usually increase significantly in the fourth calendar quarter of each year.

We May Not Be Successful in Our Efforts to Expand into International Market Segments

Our international activities are significant to our revenues and profits and we plan, over time, to continue to expand our reach in international market segments. We have relatively little experience in purchasing, marketing, and distributing products or services for these or future market segments and may not benefit from any first-to-market advantages. It is costly to establish international facilities and operations, promote our brand internationally and develop localized websites, stores, and other systems. We may not succeed in these efforts. Our net sales from international market segments may not offset the expense of establishing and maintaining the related operations and, therefore, these operations may not be profitable on a sustained basis.

Our international sales and related operations are subject to a number of risks inherent in selling abroad, including, but not limited to, risks with respect to:

- foreign 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) and restrictions on the level of foreign ownership;
- restrictions on sales of certain products or services and uncertainty regarding our liability for the products or services we offer and content provided by us or our users, including uncertainty as a result of less Internet-friendly legal systems, local laws, lack of legal precedent, and varying rules, regulations, and practices regarding the distribution of media products and enforcement of intellectual property rights;
- import, export, or other business licensing requirements;
- limitations on the repatriation of funds and foreign currency exchange restrictions;
- difficulty in obtaining distribution and support;
- nationalization or restrictions of foreign ownership;
- shorter payable and longer receivable cycles and the resultant negative impact on cash flow;

- consumer and data protection laws and restrictions on pricing or discounts;
- lower levels of adoption or use of the Internet and other technologies vital to our business and the lack of appropriate infrastructure to support widespread Internet usage;
- lower levels of consumer spending on a per capita basis and fewer opportunities for growth in certain foreign market segments compared to the U.S.;
- lower levels of credit card usage and increased payment risk;
- difficulty in staffing, developing and managing a number of unique foreign operations as a result of distance, language and cultural differences;
- different employee/employer relationships and the existence of workers' councils and labor unions;
- laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, and loans;
- tax and other laws of the U.S. and other jurisdictions; and
- geopolitical events, including war and terrorism.

As the international e-commerce channel continues to grow, competition will likely intensify. Local companies may have a substantial competitive advantage because of their greater understanding of, and focus on, the local customer, as well as their more established local brand name recognition. In addition, governments in foreign jurisdictions may regulate e-commerce or other online services in such areas as licenses, content, privacy, network security, copyright, encryption, taxation, or distribution. We may not be able to hire, train, retain, motivate, and manage required personnel, which may limit our growth in international market segments.

In 2004, we acquired Joyo.com, which is organized under the laws of the British Virgin Islands and operates *www.joyo.com* and *www.joyo.com.cn* in the People's Republic of China ("PRC") in cooperation with a PRC subsidiary and PRC affiliates. The PRC regulates Joyo.com's business through regulations and license requirements restricting (i) the scope of foreign investment in the Internet, retail and delivery sectors, (ii) Internet content and (iii) the sale of certain media products. In order to meet the PRC local ownership and regulatory licensing requirements, Joyo.com's business is operated through a PRC subsidiary which acts in cooperation with PRC companies owned by nominee shareholders who are PRC nationals. Although we believe Joyo.com's structure complies with existing PRC laws, it involves unique risks. There are substantial uncertainties regarding the interpretation of PRC laws and regulations, and it is possible that the PRC government will ultimately take a view contrary to ours. If Joyo.com or its subsidiary or affiliates were found to be in violation of any existing or future PRC laws or regulations or if interpretations of those laws and regulations were to change, the business could be subject to fines and other financial penalties, have its licenses revoked or be forced to shut down entirely. In addition, if Joyo.com were unable to enforce its contractual relationships with respect to management and control of its business, it might be unable to continue to operate the business. In addition, Joyo.com is subject to many of the risks described in "Our Business Could Suffer if We are Unsuccessful in Making, Integrating, and Maintaining Acquisitions and Investments."

If We Do Not Successfully Optimize and Operate Our Fulfillment Centers, Our Business Could Be Harmed

If we do not successfully operate our fulfillment centers, it could significantly limit our ability to meet customer demand. Because it is difficult to predict demand, we may not manage our facilities in an optimal way, which may result in excess or insufficient inventory or warehousing, fulfillment, and distribution capacity. A failure to optimize inventory in our fulfillment network will increase our net shipping cost by requiring us to make long-zone shipments or partial shipments from one or more locations. Orders from several of our internationally-focused websites are fulfilled primarily from a single fulfillment center, and we have only a limited ability to reroute orders to third parties for drop-shipping. We and our co-sourcers may be unable to adequately staff our fulfillment and customer service centers. As we continue to add fulfillment and warehouse capability or add new businesses with different fulfillment requirements, our fulfillment network becomes increasingly complex and operating it becomes more challenging. There can be no assurance that we will be able to operate our network effectively.

We rely on a limited number of shipping companies to deliver inventory to our fulfillment centers and completed orders to our customers. If we are not able to negotiate acceptable terms with these companies or they experience performance problems or other difficulties, it could negatively impact our operating results and customer experience. In addition, our ability to receive inbound inventory efficiently and ship completed orders to customers also may be negatively affected by inclement weather, fire, flood, power loss, earthquakes, labor disputes, acts of war or terrorism, acts of God and similar factors.

Third parties either drop-ship or otherwise fulfill an increasing portion of our customers' orders, and we are increasingly reliant on the reliability, quality, and future procurement of their services. Under some of our commercial agreements, we maintain the inventory of other companies in our fulfillment centers, thereby increasing the complexity of tracking inventory in and operating our fulfillment centers. Our failure to properly handle such inventory or the inability or failure of these other companies to accurately forecast product demand would result in unexpected costs and other harm to our business and reputation.

The Seasonality of Our Business Places Increased Strain on Our Operations

We expect a disproportionate amount of our net sales to be realized during the fourth quarter of our fiscal year. If we do not stock popular products in sufficient amounts or fail to have sources to timely restock popular products, such that we fail to meet customer demand, it could significantly affect our revenue and our future growth. If we overstock products, we may be required to take significant inventory markdowns or write-offs, which could reduce gross profits. A failure to optimize inventory in our fulfillment network will harm our shipping margins by requiring us to make long-zone shipments or partial shipments from one or more locations. Orders from several of our internationally-focused websites are fulfilled primarily from a single fulfillment center, and we have only a limited ability to reroute orders to third parties for drop-shipping. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery, especially for the holiday season. If the other businesses on whose behalf we perform inventory fulfillment services deliver product to our fulfillment centers in excess of forecasts, we may be unable to secure sufficient storage space and may be unable to optimize our fulfillment centers. If too many customers access our websites within a short period of time due to increased holiday or other demand, we may experience system interruptions that make our websites 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. In addition, we may be unable to adequately staff our fulfillment centers during these peak periods and third parties that provide fulfillment services to our customers may be unable to meet the seasonal demand. Finally, we, along with our customer service co-sourcers, may be unable to adequately staff customer service centers.

We generally have payment terms with our vendors that extend beyond the amount of time necessary to collect proceeds from our customers. As a result of holiday sales, at December 31 of each year, our cash, cash equivalents, and marketable securities balances typically reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). This operating cycle results in a corresponding increase in accounts payable. Our accounts payable balance should decline during the first three months following year-end, which will result in a decline in our cash, cash equivalents, and marketable securities balances.

Our Business Could Suffer if We Are Unsuccessful in Making, Integrating, and Maintaining Commercial Agreements, Strategic Alliances, and Other Business Relationships

We may enter into commercial agreements, strategic alliances, and other business relationships with other companies. We have entered into agreements to provide e-commerce services to other businesses and we plan to enter into similar agreements in the future, including as part of our Merchants@, Syndicated Stores, and Amazon

Enterprise Solutions program initiatives. Under such agreements, we may perform services such as: providing our technology services such as search, browse, and personalization; permitting other businesses and individuals to offer products or services through our websites; and powering third-party websites, either with or without providing accompanying fulfillment services. These arrangements are complex and require substantial personnel and resource commitments by us, which may constrain the number of such agreements we are able to enter into and may affect our ability to integrate and deliver services under the relevant agreements. If we fail to implement, maintain, and develop successfully the various components of such commercial relationships, which may include fulfillment, customer service, inventory management, tax collection, payment processing, licensing of third-party software, hardware, and content, and engaging third parties to perform hosting and other services, these initiatives may not be viable. The amount of compensation we receive under certain of these agreements is partially dependent on the volume of sales that the other company makes. Therefore, if the other business's website or product or services offering is not successful, we may not receive all of the compensation we are otherwise due under the agreement or may not be able to maintain the agreement. Moreover, we may not be able to succeed in our plans to enter into additional commercial relationships and strategic alliances on favorable terms.

As our commercial agreements expire or otherwise terminate, we may be unable to renew or replace these agreements on comparable terms, or at all. In the past, we amended several of our commercial agreements to reduce future cash proceeds to be received by us, shorten the term of the agreements, or both. Some of our agreements involve high margin services, such as marketing and promotional agreements, and as such agreements expire they may be replaced, if at all, by agreements involving lower margin services. In addition, several past commercial agreements were with companies that experienced business failures and were unable to meet their obligations to us. We may in the future enter into further amendments of our commercial agreements or encounter other parties that have difficulty meeting their contractual obligations to us, which could adversely affect our operating results.

Our present and future third-party services agreements, other commercial agreements, and strategic alliances create additional risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- impairment of other relationships;
- variability in revenue and income from entering into, amending, or terminating such agreements or relationships; and
- difficulty integrating under the commercial agreements.

Our Business Could Suffer if We Are Unsuccessful in Making, Integrating, and Maintaining Acquisitions and Investments

We have acquired and invested in a number of companies, and we may acquire or invest in (such as through joint ventures or other business combinations) additional companies. Acquisitions and investments create risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- problems retaining key technical and managerial personnel, resulting from, among other factors, changes in compensation, responsibilities, reporting relationships, future prospects, and the direction of the business;
- additional operating losses and expenses of the businesses we acquired or in which we invested;
- the potential impairment of amounts capitalized as intangible assets as part of the acquisition;
- the potential impairment of customer and other relationships of the company we acquired or in which we invested or our own customers as a result of any integration of operations;

- the difficulty of incorporating acquired technology and rights into our offerings and unanticipated expenses related to such integration;
- the difficulty of integrating a new company's accounting, financial reporting, management, information, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;
- the difficulty of implementing controls, procedures and policies appropriate for a larger public company at companies that prior to acquisition or investment had lacked such controls, procedures and policies;
- potential unknown liabilities associated with a company we acquire or in which we invest; and
- for foreign acquisitions and investments, additional risks related to the integration of operations across different cultures and languages, currency risks, and the particular economic, political, and regulatory risks associated with specific countries.

Finally, as a result of future acquisitions or mergers, we might need to issue additional equity securities, spend our cash, or incur debt, contingent liabilities, or amortization expenses related to intangible assets, any of which could reduce our profitability and harm our business.

We Have Foreign Exchange Risk

The results of operations of, and certain of our intercompany balances associated with, our internationally-focused websites are exposed to foreign exchange rate fluctuations. Upon translation, net sales and other operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. As we have expanded our international operations, our exposure to exchange rate fluctuations has become more pronounced. See Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Effect of Exchange Rates" for a table demonstrating the effect on our consolidated statements of operations from changes in exchange rates versus the U.S. Dollar.

In addition, our 6.875% PEACS are denominated in Euros, not U.S. Dollars. We remeasure the principal of the 6.875% PEACS quarterly based on fluctuations in the Euro/U.S. Dollar exchange ratio and record gains or losses in "Remeasurements and other" on our consolidated statements of operations. As a result, increases in the Euro relative to the U.S. Dollar increase the U.S. dollar amount we owe as interest and principal. Furthermore, we hold cash equivalents and/or marketable securities primarily in Euros, British Pounds, and Japanese Yen. Accordingly, if the U.S. Dollar strengthens compared to these currencies, cash equivalents and marketable securities balances, when translated, may be materially less than expected and vice versa.

Our Investments and the Consideration We Receive under Certain Commercial Agreements May Subject Us to a Number of Risks

In the past, we have entered into commercial agreements with other companies, including strategic alliances whereby we perform certain e-commerce services, and in exchange for our services we received cash, equity securities of these companies, and/or additional benefits, such as website traffic. The amount of compensation we receive under certain of these agreements is dependent on the volume of sales made by the other company. In some cases, we have also made separate investments in the other company by making a cash payment in exchange for equity securities of that company. We may make similar investments in the future. To the extent we have received equity securities as compensation, fluctuations in the value of such securities will affect our ultimate realization of amounts we have received as compensation for services.

In the past, we amended several of our commercial agreements to reduce future cash proceeds to be received by us, shorten the term of our commercial agreements, or both. We may in the future enter into further amendments of our commercial agreements. Although these amendments did not affect the amount of unearned revenue previously recorded by us (if any), the timing of revenue recognition of these recorded unearned amounts was changed to correspond with the terms of the amended agreements. To the extent we believe any such amendments cause or may cause the compensation to be received under an agreement to no longer be fixed or determinable, we limit our revenue recognition to amounts received, excluding any future amounts not deemed fixed or determinable. As future amounts are subsequently received, such amounts are incorporated into our revenue recognition over the remaining term of the agreement.

Our investments in equity securities are included in “Marketable securities” and “Other assets” on our consolidated balance sheets. We regularly review all of our investments in public and private companies for other-than-temporary declines in fair value. When we determine that the decline in fair value of an investment below our accounting basis is other-than-temporary, we reduce the carrying value of the securities we hold and record a loss in the amount of any such decline. In recent years, securities of companies in the Internet and e-commerce industries have experienced significant difficulties. We may conclude in future quarters that the fair values of our investments have experienced additional other-than-temporary declines. As of September 30, 2006, our recorded basis in equity securities was $15 million, including $4 million classified as “Marketable securities” and $8 million classified as “Other assets.”

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 President, 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.

System Interruption and the Lack of Integration and Redundancy in Our Systems May Affect Our Sales

Customer access to our websites and the speed with which a customer is able to navigate and make purchases on our websites directly affects the volume of goods we sell and the services we offer and thus affects our net sales. We experience occasional system interruptions and delays that make our websites unavailable or slow to respond and prevent us from efficiently fulfilling orders or providing services to third parties, which may reduce our net sales and the attractiveness of our products and services. If we are unable to continually add software and hardware, effectively upgrade our systems and network infrastructure and take other steps to improve the efficiency of our systems, it could cause system interruptions or delays and adversely affect our operating results.

Our computer and communications systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins, and similar events or disruptions. Any of these events could cause system interruption, delays, and loss of critical data, and could prevent us from accepting and fulfilling customer orders. Should this occur, it would make our product offerings less attractive to our customers and our service offerings less attractive to third parties. While we do have backup systems for certain aspects of our operations, our systems are not fully redundant and our disaster recovery planning may not be sufficient for all eventualities. In addition, we may have inadequate insurance coverage or insurance limits to compensate us for losses from a major interruption. If any of this were to occur, it could damage our reputation and be expensive or impossible to remedy.

We Have Significant Indebtedness

As of September 30, 2006, we had long-term indebtedness of $1.3 billion. We make annual or semi-annual interest payments on the indebtedness under our two convertible notes, which are due in 2009 and 2010. Although we made debt principal reduction payments, we may incur substantial additional debt in the future, and in any event a significant portion of our future cash flow from operating activities is likely to remain dedicated to the payment of interest and the repayment of principal on our indebtedness. Our indebtedness could limit our ability to obtain additional financing for working capital, capital expenditures, debt service requirements, acquisitions or other purposes in the future, as needed; to plan for, or react to, changes in technology and in our business and competition; and to react in the event of an economic downturn.

There is no guarantee that we will be able to meet our debt service obligations. If we are unable to generate sufficient cash flow or obtain funds for required payments, or if we fail to comply with covenants in our indebtedness, we will be in default. In addition, we may not be able to refinance our indebtedness on terms acceptable to us, or at all.

See Item 1 of Part I, "Financial Statements — Note 3 — Long-Term Debt and Other."

We Face Significant Inventory Risk

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 under-stocking 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 may be difficult to establish vendor relationships, determine appropriate product selection, and accurately forecast product demand. A failure to optimize inventory within our fulfillment network will increase our net shipping cost by requiring us to make split shipments from one or more locations, complimentary upgrades, and additional long-zone shipments necessary to ensure timely delivery.

As a result of our third-party services relationships with Target and other companies, these parties identify, buy, and bear the financial risk of inventory obsolescence for their corresponding stores and merchandise. As a result, if any of these parties fail to forecast product demand or optimize or maintain access to inventory, we would receive reduced service fees under the agreements and our business and reputation could be harmed.

The acquisition of certain types of inventory, or inventory from certain sources, may require significant lead-time and prepayment, and such inventory may not be returnable. We carry a broad selection and significant inventory levels of certain products, such as consumer electronics, and we may be unable to sell products in sufficient quantities or during the relevant selling seasons.

Any one of the inventory risk factors set forth above may adversely affect our operating results.

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. 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.

We also 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.

Policing unauthorized use of our proprietary rights is inherently difficult, and we may not be able to determine the existence or extent of any such unauthorized use. In addition, third parties that license our proprietary rights may take actions that diminish the value of our proprietary rights or reputation. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, the steps we take to protect our intellectual property may not adequately protect our rights or prevent third parties from infringing or misappropriating our patents, trademarks, domain names, copyrights, trade secrets, and similar proprietary rights. We also cannot be certain that others will not independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights.

Other parties also may claim that we infringe their proprietary rights. We have been subject to, and expect to continue to be subject to, claims and legal proceedings regarding alleged infringement by us of the patents, 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. In addition, we may not be able to obtain or utilize on terms that are favorable to us, or at all, licenses or other rights with respect to intellectual property we do not own in providing e-commerce services to other businesses and individuals under commercial agreements.

We Have a Limited Operating History and Our Stock Price Is Highly Volatile

We have a relatively short operating history and a rapidly evolving and unpredictable business model. The trading price of our common stock fluctuates significantly. Trading prices of our common stock may fluctuate in response to a number of events and factors, such as:

- general economic conditions;
- changes in interest rates;
- conditions or trends in the Internet and the e-commerce industry;
- fluctuations in the stock market in general and market prices for Internet-related companies in particular;
- quarterly variations in operating results;
- new products, services, innovations, and strategic developments by our competitors or us, or business combinations and investments by our competitors or us;
- changes in financial estimates by us or securities analysts and recommendations by securities analysts;
- changes in Internet regulation;
- changes in our capital structure, including issuance of additional debt or equity to the public;
- additions or departures of key personnel;
- corporate restructurings, including layoffs or closures of facilities;
- changes in the valuation methodology of, or performance by, other e-commerce companies; and
- transactions in our common stock by major investors and certain analyst reports, news, and speculation.

Any of these events may cause our stock price to rise or fall and may adversely affect our business and financing opportunities.

Future volatility in our stock price could force us to increase our cash compensation to employees or grant larger stock awards than we have historically, which could hurt our operating results or reduce the percentage ownership of our existing stockholders, or both.

Government Regulation of the Internet and E-commerce Is Evolving and Unfavorable Changes Could Harm Our Business

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet and e-commerce. Such existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, electronic contracts and other communications, consumer protection, the provision of online payment services, unencumbered Internet access to our services, and the characteristics and quality of products and services. 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 e-commerce. Unfavorable resolution of these issues may harm our business. In addition, many jurisdictions currently regulate "auctions" and "auctioneers" and may regulate online auction services. Jurisdictions may also regulate other consumer-to-consumer online markets, including certain aspects of Amazon Marketplace. This could, in turn, diminish the demand for our products and services and increase our cost of doing business.

Taxation Risks Could Subject Us to Liability for Past Sales and Cause Our Future Sales to Decrease

We do not collect sales taxes or other taxes with respect to shipments of most of our goods into most states in the U.S. Under some of our commercial agreements, the other company is the seller of record of the applicable merchandise and we are obligated to collect sales tax in most states in accordance with that company's instructions. We may enter into additional strategic alliances requiring similar tax collection obligations. Our fulfillment 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. We collect consumption tax (including value added tax, goods and services tax, and provincial sales tax) as applicable on goods and services sold by us that are ordered on our international sites. One or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies that engage in e-commerce. A successful assertion by one or more states or foreign countries that we should collect sales or other taxes on the sale of merchandise or services could result in substantial tax liabilities for past sales, decrease our ability to compete with traditional retailers, and otherwise harm our business.

Currently, decisions of the U.S. Supreme Court restrict the imposition of obligations to collect state and local sales and use taxes with respect to sales made over the Internet. However, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's position regarding sales and use taxes on Internet sales. If any of these initiatives addressed the Supreme Court's constitutional concerns and resulted in a reversal of its current position, we could be required to collect sales and use taxes in additional states. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us, put us at a competitive disadvantage if they do not impose similar obligations on all of our online competitors and decrease our future sales.

Our Vendor Relationships Subject Us to a Number of Risks

Although we continue to increase the number of vendors that supply products to us and no vendor accounts for 10% or more of our inventory purchases, we have significant vendors that are important to our sourcing. 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. If our current vendors were to 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 Be Subject to Product Liability Claims if People or Property Are Harmed by the Products We Sell

Some of the products we sell may expose us to product liability claims relating to personal injury, death, or property damage caused by such products, and may require us to take actions such as product recalls. Certain businesses and individuals also sell products using our e-commerce platform that may increase our exposure to product liability claims, such as if these sellers do not have sufficient resources to protect themselves from such claims. Although we maintain liability insurance, 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, or at all. In addition, some of our vendor agreements with our distributors, manufacturers, and third-party sellers do not indemnify us from product liability.

We Are Subject to a Number of Risks Related to Payments We Accept

We accept payments by a variety of methods, including credit card, debit card, gift certificates, direct debit from a customer's bank account, physical bank check and payment upon delivery. As we offer new payment options to our customers, like direct debit in the U.S., we may be subject to additional regulations, compliance requirements, and fraud. For certain payment transactions, including credit and debit cards, we pay interchange and other fees, which may increase over time and raise our operating costs and lower our profit margins. We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers, process electronic funds transfers, or facilitate other types of online payments, and our business and operating results could be adversely affected. Finally, we offer co-branded credit card programs that represent a significant component of our services revenue and generate high margins. If one or more of these agreements are terminated and we are unable to replace them on similar terms, or at all, it could adversely affect our operating results.

We Could Be Liable for Breaches of Security on Our Website

A fundamental requirement for e-commerce is the secure storage and transmission of confidential information. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may adversely affect our operating results.

We Could Be Liable for Fraudulent or Unlawful Activities of Sellers

The law relating to the liability of providers of online payment services is currently unsettled. In addition, we are aware that governmental agencies have investigated the provision of online payment services and could require changes in the way this business is conducted. Under Merchants@, Marketplace and certain other of our programs, we may be unable to prevent sellers from collecting payments, fraudulently or otherwise, when buyers never receive the products they ordered or when the products received are materially different from the sellers' descriptions. Under our A2Z Guarantee, we reimburse buyers for payments up to certain limits in these situations and as our third party sales grow, the cost of this program will increase and could negatively affect our operating results. Any costs we incur as a result of liability because of our A2Z Guarantee or otherwise could harm our business. In addition, the functionality of our payments program depends on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, our payments program and our businesses that use it may not be viable. Finally, we may be unable to prevent sellers in our Merchants@, Marketplace, Amazon Enterprise Solutions, and certain other programs from selling unlawful goods, from selling goods in an unlawful manner, or violating the proprietary rights of others, and could face civil or criminal liability for unlawful activities by our sellers.

We May Not Be Able to Adapt Quickly Enough to Changing Customer Requirements and Industry Standards

Technology in the e-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 websites and proprietary technology obsolete.

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Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

On August 28, 2006, we publicly announced that our Board of Directors had authorized the Company to repurchase up to $500 million of the Company's common stock on or before August 28, 2008. The table below sets forth information regarding the Company's purchases of its common stock during Q3 2006 (in millions, except per share data):

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
July 1 – July 31, 2006	—	$ —	—	$ —
August 1 – August 31, 2006	4	29.98	4	362
September 1 – September 30, 2006	4	31.60	4	248
Total	8	$ 30.69	8	

All repurchases disclosed in this table were repurchased pursuant to the August 28, 2006 Board of Directors' authorization.

Item 3. ***Defaults Upon Senior Securities***

None.

Item 4. ***Submission of Matters to a Vote of Security Holders***

None.

Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

Exhibits

Exhibit Number	Description
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 Quarterly Report on Form 10-Q for the Quarterly Period Ended March 31, 2002).
31.1	Certification of Jeffrey P. Bezos, Chairman and Chief Executive Officer of Amazon.com, Inc., pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of Thomas J. Szkutak, Senior Vice President and Chief Financial Officer of Amazon.com, Inc., pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
32.1	Certification of Jeffrey P. Bezos, Chairman and Chief Executive Officer of Amazon.com, Inc., pursuant to 18 U.S.C. Section 1350.
32.2	Certification of Thomas J. Szkutak, Senior Vice President and Chief Financial Officer of Amazon.com, Inc., pursuant to 18 U.S.C. Section 1350.

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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)

By: /S/ MARK S. PEEK

Mark S. Peek
Senior Vice President and
Chief Accounting Officer

Dated: October 24, 2006

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