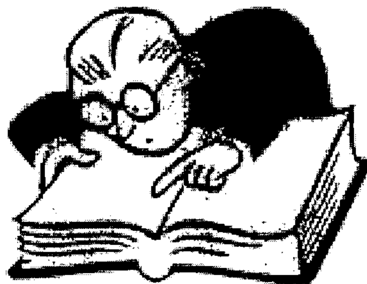

BULKY DOCUMENTS

(Exceeds 100 pages)

Filed: 7/19/2011

Title: DECLARATION OF STEPHENIE H. BALD AND EXHIBITS.

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Outbound shipping charges to customers are included in "Net sales" and, excluding amounts earned from third-party sellers where we don't provide fulfillment services, amounted to $420 million, $372 million, and $365 million for 2004, 2003, and 2002.

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 Merchants@ and Merchant.com programs. In those arrangements, as well as other product sales by third parties, the third-party maintains ownership of the related products.

Internal-Use Software

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. In accordance with Statement of Position ("SOP") 98-1, *"Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,"* we capitalize costs incurred during the application development stage related to the development 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.

During 2004, 2003, and 2002 we capitalized $44 million, $30 million, and $25 million of costs associated with development of internal-use software, which is offset by amortization of previously capitalized amounts of $30 million, $24 million, and $26 million.

Restructuring Estimates

Restructuring-related liabilities include estimates for, among other things, anticipated disposition of lease obligations. Key variables in determining such estimates include anticipated timing of sublease rentals, estimates of sublease rental payment amounts and tenant improvement costs, and estimates for brokerage and other related costs. We periodically evaluate and, if necessary, adjust our estimates based on currently-available information. Additionally, we may determine, as we did in 2004, that certain of the office space vacated as part of our 2001 restructuring, which we have been unable to sublease due to poor real estate market conditions, may be necessary for our future needs. To the extent we elect to utilize this office space, we adjust our restructuring-related liability and classify future payments to the corresponding operating expense categories on the consolidated statements of operations.

Currency Effect on Intercompany Balances

A provision of Statement of Financial Accounting Standard ("SFAS") No. 52, *Foreign Currency Translation*, requires that gains and losses arising from intercompany foreign currency transactions considered long-term investments, in which settlement is not planned or anticipated in the foreseeable future, be excluded in the determination of net income. Our international operations are financed, in part, by the U.S. parent company. Prior to the fourth quarter of 2003, currency adjustments for these intercompany balances were recorded to stockholders' deficit as translation adjustments and not included in the determination of net income because we intended to permanently invest such amounts. During the fourth quarter of 2003, we made the decision that these amounts would be repaid among the entities and, accordingly, upon consolidation, any exchange gain or loss arising from remeasurements of intercompany balances is required to be recorded in the determination of net

income. In accordance with SFAS No. 52, currency adjustments arising before the fourth quarter of 2003 continue to be included as a component of "Accumulated other comprehensive income" on our consolidated balance sheets. Resulting from the remeasurement of intercompany balances using exchange rates at the reporting dates, we recorded gains of $41 million and $36 million for 2004 and 2003. Repayments among the entities during 2004 were $210 million.

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. At December 31, 2004, our net deferred tax assets are $363 million, comprised of approximately $270 million relating to our net operating loss carryforwards ("NOLs"), with the remaining portion related to temporary timing differences between tax and financial reporting. Classification of deferred tax assets between current and long-term categories is based on the expected timing of realization, and the valuation allowance is allocated on a pro-rata basis.

We had a net tax benefit in 2004 of $233 million resulting primarily from the effect of changes in our valuation assessment of deferred tax assets during 2004. In connection with this assessment, we also recorded a net credit to "Stockholders' Deficit" of $106 million on our consolidated balance sheet in 2004. The range of possible judgments relating to the valuation of our deferred tax assets is very wide. For example, had we determined that the weight of available evidence did not support a decision that a portion of our deferred tax asset will be realized, the amount recorded to "Provision (benefit) for income taxes" would have been an expense of $12 million (rather than a benefit of $233 million) for 2004. Alternatively, if we had concluded that the weight of available evidence supported a decision that substantially all of our deferred tax assets may be realized, we would have recorded a substantially larger credit to "Stockholders' Deficit."

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.

Liquidity and Capital Resources

Our financial focus is on long-term, sustainable growth in free cash flow[1]. Free cash flow was $477 million for 2004 compared to $346 million for 2003, an increase of 38%. Operating cash flows and free cash flows can be volatile and are sensitive to many factors, including changes in working capital. Working capital at any specific point in time is subject to many variables, including seasonality, the timing of expense payments, 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 were $1.8 billion and $1.4 billion at the end of 2004 and 2003. Amounts held in foreign currencies were $970 million and $764 million at the end of 2004 and 2003, and were primarily Euros, British Pounds, and Yen.

Cash provided by operating activities was $567 million, $392 million, and $174 million in 2004, 2003, and 2002. Our operating cash flows result primarily from cash received from our customers and third-party sellers, offset by cash payments we make to suppliers of products and services, employee compensation, credit card transaction fees, bad debt, and interest payments on our long-term debt obligations. Cash received from

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1 Free cash flow 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 statements of cash flows.

customers and third-party sellers 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. During 2004, payments to product merchandise suppliers, which do not include payments to transportation suppliers, totaled $4.6 billion, an increase of $1.2 billion over the prior year. The increase in payments to product merchandise suppliers corresponds with cost of sales, and with 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, and is also affected by foreign exchange rates.

Cash provided by (used in) investing activities corresponds with purchases, sales, and maturities of marketable securities and purchases of fixed assets, including internal-use software and website development costs. Cash used in investing activities was $318 million in 2004 and $122 in 2002, while cash provided by investing activities was $237 million in 2003 with the variability caused primarily by maturities of marketable securities. Our capital expenditures, including internal-use software and website development, were $89 million, $46 million, and $39 million in 2004, 2003, and 2002, with the sequential increases primarily reflecting additional investment in development of new features and product offerings on our websites over time. We believe our expenditures for repairs and improvements are sufficient to keep our facilities and equipment in suitable operating condition.

In September 2004, we acquired all of the outstanding shares of Joyo.com at a purchase price of $75 million, including a cash payment (net of cash acquired) of $71 million, the assumption of employee stock options, and transaction-related costs. Cash paid in connection with this acquisition is classified as cash provided by (used in) investing activities on our consolidated statements of cash flows. The operating results of Joyo.com did not have a significant effect on consolidated results for 2004. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies—Business Acquisition."

Cash used in financing activities was $97 million in 2004 and $332 million in 2003. This compares to cash provided by financing activities of $107 million in 2002. Cash inflows from financing activities primarily result from proceeds from exercises of employee stock options, which were $60 million in 2004, $163 million in 2003, and $122 million for 2002. 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. Cash outflows from financing activities result from repayments of long-term debt and payments on capital lease obligations, which were $157 million in 2004, $495 million in 2003, and $15 million in 2002. During 2004, we paid $154 million, which includes a redemption premium of $4 million, to redeem a portion of our 4.75% Convertible Subordinated Notes due 2009 ("4.75% Convertible Subordinated Notes"). See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 4—Long-Term Debt and Other."

In 2004 we recorded a primarily non-cash net benefit of $233 million to "Provision (benefit) for income taxes" relating primarily to our valuation of deferred tax assets. We expect our cash taxes paid in 2005 to be approximately $25 million, compared with $4 million in 2004.

On March 7, 2005, we redeemed 200 million Euros principal of our 6.875% PEACS for a cash payment of $266 million, which includes $1 million of interest from and including February 16 through March 6, 2005. Under the Indenture, no premium was required. As of March 7, 2005, the outstanding principal amount of our 6.875% PEACS was 490 million Euros ($649 million using the Euro to U.S. Dollar exchange rate on that date).

Additionally, in March 2005, our Board of Directors authorized a new debt repurchase program, replacing our previous debt repurchase authorization in its entirety, pursuant to which we may from time to time repurchase (through open market repurchases or private transactions), redeem, or otherwise retire up to an aggregate of $500 million of our outstanding 4.75% Convertible Subordinated Notes and 6.875% PEACS.

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. We currently do not hedge our exposure to foreign currency effects on our interest or principal obligations relating to the 6.875% PEACS, and, 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 expense (income), net" on our consolidated statements of operations.

The following summarizes our principal contractual commitments as of December 31, 2004:

	2005	2006	2007	2008	2009	Thereafter	Total
				(in thousands)			
Operating and capital commitments:							
Debt principal and other (1)	$ 128	$ 1,250	$ 340	$ 373	$ 899,760	$ 951,089	$1,852,940
Debt interest (1)	107,026	107,026	107,026	107,026	85,656	64,287	578,047
Capital leases	1,298	510	22	—	—	—	1,830
Operating leases (2)	61,222	64,390	55,678	51,990	43,184	186,737	463,201
Purchase obligations (3)	227,950	—	—	—	—	—	227,950
Total operating and capital commitments	397,624	173,176	163,066	159,389	1,028,600	1,202,113	3,123,968
Restructuring-related commitments:							
Operating leases, net of estimated sublease income (4)	3,057	1,903	1,843	1,497	1,374	1,305	10,979
Other	1,910	—	—	—	—	—	1,910
Total restructuring-related commitments	4,967	1,903	1,843	1,497	1,374	1,305	12,889
Total commitments	$402,591	$175,079	$164,909	$160,886	$1,029,974	$1,203,418	$3,136,857

(1) The principal payment due in 2010 and the annual interest payments due under our 6.875% PEACS fluctuate based on the Euro/U.S. Dollar exchange ratio, which, at December 31, 2004, was 1.3552. As of December 31, 2004, our principal debt obligation for the 6.875% PEACS has increased by $255 million since its issuance in February 2000 due to fluctuations in the Euro/U.S. Dollar exchange ratio. Additionally, on March 7, 2005, we redeemed 200 million Euros of our outstanding 6.875% PEACS, which is not reflected in the table above.

(2) Pursuant to SFAS No. 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 No. 13 they are not reflected on the balance sheet. As of December 31, 2004, we have remaining obligations under operating leases for equipment and real estate of $463 million. If we had applied to our operating leases the same convention used for capital leases, which, however, would not be in accordance with GAAP, we would have recorded approximately $335 million of additional obligations on our balance sheet at December 31, 2004.

(3) Consists primarily of legally-binding commitments to purchase inventory. Legally-binding commitments associated with non-inventory purchases are not significant.

(4) Net of an estimated $20 million in sublease rentals. At December 31, 2004, we had signed sublease agreements totaling $13 million.

Pledged Securities

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 and for real estate lease agreements. The amount required to be pledged for real estate lease agreements changes over the life of our leases; with fluctuations in our market capitalization, which is common shares outstanding multiplied by the closing price of our common stock; and based on our credit-rating. The change in the total amount of collateral required to be pledged under these agreements is as follows:

	Standby Letters of Credit (1)	Line of Credit (2)	Real Estate Leases (3)	Total
		(in thousands)		
Balance at December 31, 2003	$ 60,799	$ —	$ 25,936	$ 86,735
Net change in collateral pledged	(10,383)	1,933	(4,412)	(12,862)
Balance at December 31, 2004 (4)	$ 50,416	$ 1,933	$ 21,524	$ 73,873

(1) Pursuant to available standby letter-of-credit facilities totaling $151 million.

(2) Pursuant to an available line of credit totaling $10 million.

(3) The required amount of collateral to be pledged on certain of our real estate leases fluctuates based on our market capitalization. At December 31, 2004, our market capitalization was $18.1 billion. If our market capitalization decreases, the required amount of collateral to be pledged will increase $5 million (if market capitalization is less than $18 billion but more than $13 billion) or $11 million (if our market capitalization is less than $13 billion).

(4) Includes $10 million of cash equivalents pledged as collateral. See "Note 2—Cash, Cash Equivalents, and Marketable Securities."

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 1 of Part I "Business—Additional Factors That May Affect Future Results." 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 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 operating decision maker reviews our operating results in assessing performance and allocating resources.

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Net Sales and Gross Profit

Net sales information is as follows:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Net Sales:			
North America	$3,847,344	$3,258,413	$2,761,457
International	3,073,780	2,005,286	1,171,479
Consolidated	$6,921,124	$5,263,699	$3,932,936
Net Sales Growth Rate:			
North America	18.1%	18.0%	12.2%
International	53.3	71.2	76.9
Consolidated	31.5	33.8	26.0
Net Sales Mix:			
North America	55.6%	61.9%	70.2%
International	44.4	38.1	29.8
Consolidated	100.0%	100.0%	100.0%

Revenue growth is due primarily to increased demand driven by increased selection, lower prices, including from our free shipping offers, and improved features and services available on our websites. Revenue growth is also affected by changes in exchange rates. See "Effect of Exchange Rates" below for additional information on the effect on reported revenue of changes in exchange rates. Net sales from "Other" consist of non-retail activities, such as our Merchant.com program, miscellaneous marketing and promotional activities, and our co-branded credit card program.

North America revenue growth rate in 2004 was consistent with 2003 at 18%, up from our 2002 growth rate of 12%. The increase in growth rates from 2002 reflects our efforts to increase product categories and selection available on our websites, and to continue reducing prices for our customers, including from our free shipping offers.

International revenue growth rate declined in 2004 and 2003 compared to the prior year periods, which reflects several factors. These factors include the increasing size of our business, which naturally causes growth rates to decline over time, offset by our customer experience initiatives including new category introductions; increased selection; the introduction of our third-party offerings in the UK, Germany, Japan, and France; and our efforts to reduce prices for our customers, including from our free shipping offers. International segment revenue growth rates are also affected by changes in exchange rates.

The relative mix of worldwide net sales attributed to our International segment continues to increase, and we expect that, over time, our International segment will represent 50% or more of our consolidated total. Additionally, as we continue to offer increased selection, lower prices, and additional product lines in our Electronics and other general merchandise category, we expect to see the relative mix of sales from this category increase.

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Gross profit information is as follows:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Gross Profit:			
North America	$1,023,552	$ 866,664	$740,985
International	578,445	390,504	251,633
Consolidated	$1,601,997	$1,257,168	$992,618
Gross Profit Growth Rate:			
North America	18.1%	17.0%	12.7%
International	48.1	55.2	78.0
Consolidated	27.4	26.7	24.3
Gross Margin:			
North America	26.6%	26.6%	26.8%
International	18.8	19.5	21.5
Consolidated	23.1	23.9	25.2

The increases in gross profit in absolute terms during 2004 and 2003 compared to prior year periods correspond with increased revenue, including from increased sales volume by third-party sellers, offset by our year-round free shipping offers and lower prices for customers. Generally, our gross margins fluctuate based on several factors, including our product and geographic mix of sales during the year; sales volumes by third-party sellers; changes in vendor pricing; lowering prices for customers, including from competitive pricing decisions; and the extent to which our customers accept our free shipping offers. Free shipping offers reduce shipping revenue and reduce our gross margins on retail sales. We view our shipping offers as an effective marketing tool and intend to continue offering them indefinitely. Additionally, in 2005, we introduced a new shipping membership program, Amazon Prime, in which members receive free two-day shipping and discounted overnight shipping.

North America segment gross margin in 2004 was consistent with 2003, with each of these years down slightly from 2002. Changes in mix of product sales towards lower gross margin product categories and price reductions for our customers, including from our year-round free shipping offers, were offset partially by increased sales volume by third-party sellers and volume discounts we receive from our product suppliers.

International segment gross margins declined during 2004 and 2003 compared to prior periods resulting from our efforts to continue reducing prices for customers, including from our free shipping offers, and from a shift in mix of product sales towards lower gross margin product categories, offset partially by increases in sales volume by third-party sellers.

Sales of products by third-party sellers on our websites continue to increase, representing 26%, 22%, and 17% of unit sales in 2004, 2003, and 2002. Since revenues from these sales are recorded as a net amount, they generally result in lower revenues but higher gross margin per unit. If product sales by third-party sellers continue to increase, we anticipate the higher gross margin attributes of these sales will partially offset the effect on our gross margins of our strategy to lower prices for customers over time by offering additional or broader price reductions, free shipping offers, and other promotions.

Gross profit growth is also affected by changes in exchange rates. See "Effect of Exchange Rates" below for additional information on the effect on reported gross profit of changes in exchange rates.

Supplemental Information

Supplemental information about shipping results is as follows:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Shipping Activity:			
Shipping revenue	$ 420,053	$ 372,000	$ 364,749
Outbound shipping costs	(616,572)	(508,468)	(404,303)
Net shipping cost	$(196,519)	$(136,468)	$ (39,554)

We believe that offering low prices to our customers is fundamental to our future success. One way we offer lower prices is through free-shipping offers that result in a net cost to us in delivering products. Additionally, in 2005, we continued to lower prices, including by introducing a new shipping membership program, Amazon Prime, in which members receive free two-day shipping and discounted overnight shipping. We seek to partially offset these costs over time through achieving higher sales volumes, negotiating better terms with our suppliers, and achieving better operating efficiencies, including by reducing split-shipments.

Supplemental information about our net sales is as follows:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Net Sales:			
North America			
Media	$2,589,438	$2,269,472	$1,994,949
Electronics and other general merchandise	1,127,754	878,519	681,041
Other	130,152	110,422	85,467
Total North America	$3,847,344	$3,258,413	$2,761,457
International			
Media	$2,512,911	$1,779,476	$1,103,665
Electronics and other general merchandise	558,490	224,606	65,877
Other	2,379	1,204	1,937
Total International	$3,073,780	$2,005,286	$1,171,479
Consolidated			
Media	$5,102,349	$4,048,948	$3,098,614
Electronics and other general merchandise	1,686,244	1,103,125	746,918
Other	132,531	111,626	87,404
Total consolidated	$6,921,124	$5,263,699	$3,932,936
Net Sales Growth Rate:			
North America			
Media	14.1%	13.8%	10.2%
Electronics and other general merchandise	28.4	29.0	17.9
Other	17.9	29.2	17.7
Total North America	18.1	18.0	12.2
International			
Media	41.2%	61.2%	71.0%
Electronics and other general merchandise	148.7	240.9	308.3
Other	97.6	(37.8)	279.8
Total International	53.3	71.2	76.9
Consolidated			
Media	26.0%	30.7%	26.2%
Electronics and other general merchandise	52.9	47.7	25.8
Other	18.7	27.7	19.5
Total consolidated	31.5	33.8	26.0
Consolidated Net Sales Mix:			
Media	73.7%	76.9%	78.8%
Electronics and other general merchandise	24.4	21.0	19.0
Other	1.9	2.1	2.2
Total consolidated	100.0%	100.0%	100.0%
North America	55.6%	61.9%	70.2%
International	44.4	38.1	29.8
Total consolidated	100.0%	100.0%	100.0%

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Direct Segment Operating Expenses

Information about the operating expense categories that we allocate to our segment results is as follows:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Segment Operating Expenses:			
North America	$702,676	$583,619	$561,318
International	409,158	312,311	251,198
Percent of Net Sales:			
North America	18.3%	17.9%	20.3%
International	13.3	15.6	21.4
Segment Operating Expenses:			
Fulfillment (1)	$590,397	$477,032	$392,467
Marketing (2)	158,022	122,787	125,383
Technology and content (3)	251,195	207,809	215,617
General and administrative (4)	112,220	88,302	79,049
Percent of Net Sales:			
Fulfillment (1)	8.5%	9.1%	10.0%
Marketing (2)	2.3	2.3	3.2
Technology and content (3)	3.6	3.9	5.5
General and administrative (4)	1.6	1.7	2.0
Year-over-year Percentage Change:			
Fulfillment (1)	24%	22%	5%
Marketing (2)	29	(2)	(9)
Technology and content (3)	21	(4)	(11)
General and administrative (4)	27	12	(12)

(1) Fulfillment

The increase in fulfillment costs in absolute dollars in comparison with the prior year relates to variable costs corresponding with sales volume; our mix of product sales; costs associated with credit card fees; and bad debt costs, including costs of our guarantee for certain third-party seller transactions. The mix of product sales affects fulfillment costs per shipment based on variations in shape and weight of products we sell. Additionally, since credit card fees associated with third-party seller transactions are based on the gross purchase price of underlying transactions, and bad debt costs are higher as a percentage of revenue versus our retail sales, our increasing third-party sales result in increasing fulfillment costs as a percent of net sales. Also, during the third quarter of 2004 we began operation of a new European fulfillment center in Scotland and plan to expand our fulfillment capacity in Japan in 2005. Fulfillment costs as a percentage of net sales decreased due to improvements in productivity and accuracy, the increase in units fulfilled, which leverages the fixed-cost portion of our fulfillment network, efficiencies gained through utilization of fulfillment services provided by third parties, a decline in customer service contacts per unit resulting from improvements in our operations, and enhancements to our customer self-service features, offset partially by increases in credit card fees and bad debt, including costs of our guarantee for certain third-party seller transactions. We expect absolute amounts spent in fulfillment to increase over time.

(2) 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. Since our marketing expenses are largely variable, we expect absolute amounts spent in marketing to increase over time. 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. Marketing costs increased in absolute terms in 2004 corresponding with revenue growth as we utilized variable online marketing channels such as our Associates and Syndicated Stores programs, sponsored search, and other variable marketing initiatives. While costs associated with free shipping are not included in marketing expense, we view free shipping as an effective worldwide marketing tool, and intend to continue offering it indefinitely.

(3) Technology and Content

Our spending in technology and content has increased as we are adding computer scientists and software engineers to continue to enhance the customer experience on our websites and those websites powered by us and to improve our process efficiency. Additionally, we continue to invest in several areas of technology, including seller platform; A9.com, our wholly-owned subsidiary focused on search technology on *www.A9.com*, *www.amazon.com*, and other Amazon sites; web services; and digital initiatives. During 2004, 2003, and 2002 we capitalized $44 million, $30 million, and $25 million of costs associated with development of internal-use software, which is offset by amortization of previously capitalized amounts of $30 million, $24 million, and $26 million. We intend to continue investing in these and other initiatives and expect absolute dollars spent in technology and content to increase over time as we continue to add computer scientists and software engineers to our staff. A significant majority of these costs are incurred in the United States and most of them are allocated to our North America segment.

(4) General and Administrative

The increase in spending in general and administrative is primarily due to increases in professional fees and litigation costs. We expect absolute dollars spent in general and administrative to increase over time.

On an annual basis in 2004, each category of direct segment operating expenses has either declined or remained flat with 2003 as a percentage of net sales. However, for the fourth quarter of 2004 expenses for "Marketing" and "Technology and content" as a percentage of net sales increased in comparison to same period in 2003, and this trend may continue.

Stock-Based Compensation

On October 13, 2004, the Financial Accounting Standards Board reached a consensus on the effective date for SFAS No. 123R (SFAS 123R), *Share-Based Payment*. SFAS 123R requires us to measure compensation cost for all outstanding unvested share-based awards at fair value beginning on July 1, 2005, however we will early-adopt the provisions of SFAS 123R with an implementation date of January 1, 2005. The adoption of this standard will not affect the stock-based compensation associated with our restricted stock and restricted stock units which are already recorded at fair value on the date of grant and recognized over the service period, but will result in the recognition of stock-based compensation in future periods for remaining unvested stock options as of the effective date. As of the implementation date of this standard, we will no longer have employee stock awards subject to variable accounting treatment. We estimate that stock-based compensation for 2005 will be $115 million. See also Item 8 of Part II, "Financial Statements—Note 1—Description of Business and Accounting Policies–Stock-based Compensation" for our SFAS No. 123 pro forma disclosures using fair value accounting treatment.

Stock-based compensation consisted of the following:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Stock awards—variable accounting (1)	$ 4,577	$51,875	$60,130
Fixed accounting (2):			
Restricted stock units (3)	48,625	30,691	3,913
Restricted stock (4)	4,500	5,185	4,884
Total stock-based compensation	$57,702	$87,751	$68,927

(1) Variable accounting treatment results in expense or contra-expense recognition using the cumulative expense method, calculated based on the quoted price of our common stock and vesting schedules of underlying awards. To the extent stock options are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to "Stock-based compensation."

(2) The fair value of awards is determined at grant date based on the number of shares granted and the quoted price of our common stock. Such value is recognized as expense over the service period using the accelerated method under FIN No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.* To the extent awards are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to stock-based compensation.

(3) Since October 2002, we have awarded restricted stock units as our primary form of stock-based compensation.

(4) Includes expense associated with matching contributions of 0.07 million and 0.03 million shares of our common stock under our 401(k) savings plan during 2004 and 2003. No matching contributions were made in 2002.

At December 31, 2004, we had 25 million stock awards outstanding, including 18 million stock options with a $12.98 weighted average exercise price; 6 million restricted stock units; and 1 million shares of restricted stock. Common shares outstanding (which include restricted stock) plus shares underlying stock options and restricted stock units totaled 434 million and 433 million at December 31, 2004 and 2003. For additional information about our stock-based compensation and awards see Item 8 of Part II, "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies—Stock-based Compensation."

Other Operating Expense (Income)

Other operating expense (income) was $(8) million, $3 million, and $47 million for 2004, 2003, and 2002, which includes restructuring-related expenses (credits) and amortization of other intangibles. Restructuring-related expenses (credits) were $(9) million, $0 million, and $42 million; and amortization of other intangibles was $1 million, $3 million, and $5 million for 2004, 2003, and 2002.

During 2004, we determined that certain of the office space previously vacated as part of our 2001 restructuring, which we had been unable to sublease due to poor real estate market conditions, was necessary for our future needs. We have reduced our restructuring-related liability resulting in a gain of $13 million in 2004. Lease-related payments for this office space, approximately $0.8 million per quarter, are expensed over the lease period and classified to the corresponding operating expense categories on the consolidated statements of operations.

In 2004, we streamlined our organizational structure in France to reduce our operating costs. These efforts were primarily focused on eliminating French office positions in managerial, professional, clerical, and technical roles. The number of employees affected totaled 52 and resulted in severance costs of $4 million classified in "Other operating expense (income)" on the consolidated statements of operations.

Cash payments resulting from our operational restructurings were $9 million, $26 million, and $45 million for 2004, 2003, and 2002. Based on currently available information, we estimate the remaining restructuring-related cash outflows will be as follows:

	Leases	Other	Total
		(in thousands)	
Year Ended December 31,			
2005	$ 3,057	$1,910	$ 4,967
2006	1,903	—	1,903
2007	1,843	—	1,843
2008	1,497	—	1,497
2009	1,374	—	1,374
Thereafter	1,305	—	1,305
Total estimated cash outflows (1)	$ 10,979	$1,910	$ 12,889

(1) Cash flows are presented net of an estimated $20 million in sublease rentals. At December 31, 2004, we had signed contractual sublease agreements totaling $13 million.

For additional information about our operational restructuring, see Item 8 of Part II, "Financial Statements and Supplementary Data—Note 8—Other Operating Expense (Income)."

Income from Operations

Our income from operations was $440 million, $271 million, and $64 million during 2004, 2003, and 2002. These increases primarily result from net sales and gross profit growth and declines in operating expenses as a percent of net sales as we leverage the fixed cost portion of our cost structure and seek to improve our variable costs through process efficiencies. Additionally, in 2004 and 2003 operating income improved from year-over-year reductions of $47 million and $8 million in stock-based compensation expense associated with variable accounting, offset by increases in stock-based compensation of $18 million and $27 million associated with restricted stock units.

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% U.S. Convertible Subordinated Notes and 690 million Euros ($935 million based on the exchange rate at December 31, 2004) of 6.875% PEACS at December 31, 2004. Interest expense was $107 million, $130 million, and $143 million in 2004, 2003, and 2002, with declines primarily relating to principal repayments of $150 million and $464 million in 2004 and 2003.

At December 31, 2004, our total long-term indebtedness was $1.86 billion compared to $1.95 billion a year ago. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 4—Long-Term Debt and Other."

We generally invest our excess cash in "A" rated or higher short- to intermediate-term fixed income securities and money market mutual funds. Our interest income corresponds with the average balance of invested funds and the prevailing rates we are earning on them.

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Other Income (Expense), Net

Other income (expense), net consisted of the following:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Gains on sales of marketable securities, net	$ 586	$ 9,598	$ 5,700
Foreign-currency transaction losses, net	(5,214)	(3,043)	(1,086)
Other miscellaneous gains (losses), net	(73)	(41)	309
Total other income (expense), net	$(4,701)	$ 6,514	$ 4,923

Foreign-currency transaction losses primarily relate to the interest payable on our 6.875% PEACS. Since these payments are settled in Euros, the balance of interest payable (which is paid annually in February) is subject to gains or losses resulting from changes in exchange rates between the U.S. Dollar and Euro between reporting dates and payment.

Remeasurements and Other

Remeasurements and other consisted of the following:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Foreign-currency losses on remeasurement of 6.875% PEACS (1)	$(65,375)	$(140,130)	$(103,136)
Gains on sales of Euro-denominated investments, net	9,469	5,827	2,227
Gains on sales of equity investments, net	15,406	796	13,044
Loss on redemption of long-term debt	(5,672)	(23,829)	—
Loss on termination of Euro Currency Swap (2)	—	(5,880)	—
Foreign-currency effect on intercompany balances (3)	40,883	35,574	—
Other-than-temporary impairments and other (4)	4,465	(2,455)	(12,577)
Total remeasurements and other	$ (824)	$(130,097)	$(100,442)

(1) Each period the remeasurement of our 6.875% PEACS from Euros to U.S. Dollars results in gains or losses recorded to "Remeasurements and other" on our consolidated statements of operations.

(2) Represents the remaining basis at date of termination of our Euro Currency Swap that previously was designated as a cash flow hedge of a portion of our 6.875% PEACS principal and interest.

(3) Represents the gains associated with the remeasurement of intercompany balances due to changes in foreign exchange rates. See "Item 8 of Part II—Financial Statements—Note 1—Description of Business and Accounting Policies."

(4) Included in 2004 is a gain of $6 million relating to the settlement of a contractual dispute, and included in 2003 and 2002 is $0.4 million and $4 million of losses from equity-method investees. No equity-method losses or income were recorded in 2004.

Income Taxes

We record a tax provision or benefit for current and deferred U.S. federal, state, and foreign income taxes for all periods presented, classified as "Provision (benefit) for income taxes" on the consolidated statements of operations.

We periodically evaluate the likelihood of the realization of deferred tax assets, and reduce the carrying amount of these deferred tax assets 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 carryforward 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.

We had a net current tax benefit in 2004 of $233 million, representing $0.57 and $0.55 of basic and diluted earnings per share, resulting primarily from the effect of changes in our valuation assessment of deferred tax assets during 2004. In connection with this assessment we also recorded a net credit to "Stockholders' Deficit" of $106 million on our consolidated balance sheet in 2004.

At December 31, 2004, our net deferred tax assets are $363 million, comprised of approximately $270 million relating to our NOLs, with the remaining portion related to temporary timing differences between tax and financial reporting. Classification of deferred tax assets between current and long-term categories is based on the expected timing of realization, and the valuation allowance is allocated ratably.

At December 31, 2004, our gross deferred tax assets related to our NOLs were approximately $800 million (relating to approximately $2.6 billion of NOLs), offset by a valuation allowance of approximately $530 million due to uncertainty about their future realization. If in the future, we determine that the remaining $530 million of NOL deferred tax assets is more likely than not to be realizable, substantially all would be credited to "Stockholders' Deficit" rather than the income statement since they primarily relate to tax-deductible stock-based compensation in excess of amounts recognized for financial reporting purposes. The majority of our NOLs expire after 2016.

We also have approximately $70 million of deferred tax assets relating to approximately $225 million capital loss carryforwards that expire in 2005 and thereafter. Due to uncertainty regarding future realization, we have provided a full valuation allowance for this portion of our deferred tax asset.

Additionally, we expect net income for 2005 to decline because we expect a tax provision in 2005 rather than the large tax benefit we received in 2004. We expect our cash taxes paid in 2005 to be approximately $25 million, compared with $4 million in 2004 and $2 million in 2003.

Net Income

Net income was $588 million and $35 million in 2004 and 2003, and net loss was $149 million in 2002. We believe that our reported net income for 2004 should not be viewed, on its own, as a material positive event, and the year-over-year increases in net income of $553 million and $184 million in 2004 and 2003 are not necessarily predictive of our future results for a variety of reasons. For example, in 2004 we had a net benefit from income taxes of $233 million, representing $0.57 and $0.55 of basic and diluted earnings per share, resulting primarily from changes in valuation of deferred tax assets associated with our net operating loss carryforwards attributable to continuing operations. Additionally, the remeasurement of our 6.875% PEACS and intercompany balances resulted in significant gains and charges associated with the effect of movements in currency exchange rates. Accordingly, we encourage readers of our financial statements to evaluate the effect on our operating trends of these items since future income taxes and change in currency exchange rates may create significant variability in our future operating results.

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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:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands, except per share amounts)	
Exchange-rate effect on (1):			
Net sales	$275,653	$232,370	$ 46,950
Gross profit	52,183	46,392	9,930
Operating expenses	32,011	32,054	6,039
Operating income	20,172	14,338	3,891
Net interest expense and other	8,801	11,135	2,393
Remeasurements and other (2)	15,023	98,729	100,879
Net income (loss)	(3,652)	(95,526)	(99,381)
Diluted earnings (loss) per share	$ (0.01)	$ (0.23)	$ (0.26)

(1) Represents the effect on reported results due to year-over-year changes in exchange rates. Absent year-over-year changes in exchange rates, reported amounts would have been lower (higher) by these amounts.

(2) 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. functional-currency subsidiary. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 10—Remeasurements and Other."

Non-GAAP Financial Measure: Free Cash Flow

Regulation G, *Conditions for Use of Non-GAAP Financial Measures*, and other provisions of the 1934 Act 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 investors to review our financial statements and publicly-filed reports in their entirety and to not rely on any single financial measure.

Free cash flow, which we reconcile to "Cash provided by (used in) 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 such as our 2004 acquisition of Joyo.com (see Item 8 of Part II, "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies"). 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, "Cash provided by operating activities" for 2004, 2003, and 2002 (in thousands):

	Year Ended December 31,		
	2004	2003	2002
Net cash provided by operating activities	$ 566,560	$ 392,022	$ 174,291
Purchases of fixed assets, including internal-use software and website development	(89,133)	(45,963)	(39,163)
Free cash flow	$ 477,427	$ 346,059	$ 135,128
Net cash provided by (used in) investing activities	$(317,631)	$ 236,651	$(121,684)
Net cash provided by (used in) financing activities	$ (97,292)	$(331,986)	$ 106,894

Guidance

The Company provided guidance on February 2, 2005 in its earnings release furnished on Form 8-K as follows:

First Quarter 2005 Guidance

- Net sales are expected to be between $1.80 billion and $1.95 billion, or grow between 18% and 27%, compared with first quarter 2004.
- Operating income is expected to be between $80 million and $110 million, or decline between (28%) and 0%, compared with first quarter 2004, assuming, among other things, that the Company adopts SFAS No. 123R on January 1, 2005, stock-based compensation is $25 million, and there are no further revisions to restructuring-related estimates.

Full Year 2005 Expectations

- Net sales are expected to be between $8.05 billion and $8.65 billion, or grow between 16% and 25%.
- Operating income is expected to be between $385 million and $510 million, or between (13%) and 16% growth, compared with 2004, assuming, among other things, that the Company adopts SFAS No. 123R on January 1, 2005, stock-based compensation is $115 million, and there are no further revisions to restructuring-related estimates.

These projections are subject to substantial uncertainty. See Item 1 of Part 1, "Business — Additional Factors That May Affect Future Results."

Item 7A. ***Quantitative and Qualitative Disclosure 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 disclosure about market risk is set forth below and in "Liquidity and Capital Resources," above.

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 balance sheets. We generally invest our excess cash in "A" rated or higher, short- to intermediate-term fixed income securities and money market mutual

funds. Fixed rate securities may have their fair 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 fair value due to changes in interest rates.

The following table provides information about our cash equivalent and marketable fixed income securities, including principal cash flows by expected maturity and the related weighted average interest rates at December 31, 2004 (in thousands, except percentages):

	2005	2006	2007	2008	2009	Thereafter	Total	Estimated Fair Value at December 31, 2004
Commercial paper and short-term obligations	$ 122,073	$ —	$ —	$ —	$ —	$ —	$ 122,073	$ 124,215
Weighted average interest rate	2.10%	—	—	—	—	—	2.10%	
Certificates of deposit	496,412	—	—	—	—	—	496,412	496,412
Weighted average interest rate	2.52%	—	—	—	—	—	2.52%	
Corporate notes and bonds	240,213	3,760	2,900	8,000	13,390	—	268,263	275,058
Weighted average interest rate	2.25%	3.45%	4.00%	4.00%	4.00%	—	2.43%	
Asset-backed and agency securities	136,202	134,754	21,127	21,570	8,500	—	322,153	323,245
Weighted average interest rate	2.32%	4.01%	3.58%	3.00%	3.00%	—	3.17%	
Treasury notes and bonds	11,845	67,205	32,620	21,100	10,500	—	143,270	140,728
Weighted average interest rate	2.43%	2.87%	3.18%	3.00%	3.00%	—	2.93%	
Cash equivalents and marketable fixed-income securities	$1,006,745	$205,719	$56,647	$50,670	$32,390	$ —	$1,352,171	$1,359,658

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The following table provides information about our cash equivalent and marketable fixed income securities, including principal cash flows by expected maturity and the related weighted average interest rates at December 31, 2003 (in thousands, except percentages):

	2004	2005	2006	2007	2008	Thereafter	Total	Estimated Fair Value at December 31, 2003
Commercial paper and short-term obligations	$675,061	$ —	$ —	$ —	$ —	$ —	$675,061	$ 675,061
Weighted average interest rate	2.00%	—	—	—	—	—	2.00%	
Certificates of deposit	27,395	—	—	—	—	—	27,395	27,395
Weighted average interest rate	2.00%	—	—	—	—	—	2.00%	
Corporate notes and bonds	11,280	2,000	8,520	2,330	—	—	24,130	24,997
Weighted average interest rate	1.34%	1.51%	1.96%	1.96%	—	—	1.68%	
Asset-backed and agency securities	20,700	18,875	30,370	14,440	—	—	84,385	85,692
Weighted average interest rate	1.22%	1.88%	2.03%	2.32%	—	—	1.83%	
Treasury notes and bonds	4,000	6,751	95,770	37,600	—	—	144,121	145,778
Weighted average interest rate	1.12%	1.59%	1.50%	2.12%	—	—	1.96%	
Cash equivalents and marketable fixed-income securities	$738,436	$27,626	$134,660	$54,370	$ —	$ —	$955,092	$ 958,923

At December 31, 2004, we had long-term debt of $1.86 billion primarily associated with our 4.75% Convertible Subordinated Notes and 6.875% PEACS, which are due in 2009 and 2010. The fair value of our long-term debt will fluctuate with movements of interest rates, increasing in periods of declining rates of interest and declining in periods of increasing rates of interest.

Based upon quoted market prices at prevailing exchange rates, the fair value of the 6.875% PEACS was 691 million Euros ($936 million) and 690 million Euros ($870 million) at December 31, 2004 and December 31, 2003, and the fair value of the 4.75% Convertible Subordinated Notes was $907 million (outstanding principal of $900 million) and $1.06 billion (outstanding principal of $1.05 billion) at December 31, 2004 and 2003.

Foreign Exchange Risk

During 2004, 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 44% 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 include Euros, British Pounds, Yen, Canadian Dollars, and Chinese Yuan. 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 during 2004, International segment revenues improved $271 million and our operating results improved $20 million in comparison with the prior year.

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 December 31, 2004 of $970 million, an assumed 5%, 10%, and 20% negative currency movement would result in fair value declines of $49 million, $97 million, and $194 million. All investments are classified as "available for sale," as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*

We have foreign exchange risk related to our 6.875% PEACS, which have an outstanding principal balance at December 31, 2004 of 690 million Euros ($935 million, based on the exchange rate as of December 31, 2004). Due to fluctuations in the Euro/U.S. Dollar exchange ratio, which we cannot predict, our principal debt obligation under the 6.875% PEACS since issuance in February 2000 has increased by $255 million as of December 31, 2004. 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 $47 million, $94 million, and $187 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% in 2004, we would incur $3 million, $6 million, and $13 million additional annual interest expense due solely to fluctuations in foreign exchange.

See "Effect of Exchange Rates" for additional information on the effect on reported results of changes in exchange rates. See also Item 8 of Part II, "Financial Statements and Supplementary Data—Note 15—Subsequent Events (Unaudited)."

Investment Risk

As of December 31, 2004, our recorded basis in equity securities (including both publicly-traded and private companies) was $27 million, including $12 million classified as "Marketable securities," and $15 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 December 31, 2004 of $64 million (recorded basis of $20 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 $10 million, $19 million, and $32 million.

Item 8. ***Financial Statements and Supplementary Data***

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REPORT OF ERNST & YOUNG LLP
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Amazon.com, Inc.

We have audited the accompanying consolidated balance sheets of Amazon.com, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' deficit, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Amazon.com, Inc. at December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Amazon.com, Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Seattle, Washington
February 24, 2005

AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2004	2003	2002
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 1,102,273	$ 738,254	$ 540,282
OPERATING ACTIVITIES:			
Net income (loss)	588,451	35,282	(149,132)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation of fixed assets, including internal-use software and website development, and other amortization	75,724	75,558	82,274
Stock-based compensation	57,702	87,751	68,927
Other operating expense (income)	(7,964)	2,752	8,948
Gains on sales of marketable securities, net	(586)	(9,598)	(5,700)
Remeasurements and other	824	130,097	100,442
Non-cash interest expense and other	4,756	12,918	29,586
Deferred income taxes	(256,696)	931	(553)
Cumulative effect of change in account principle	—	—	(801)
Changes in operating assets and liabilities:			
Inventories	(168,896)	(76,786)	(51,303)
Accounts receivable, net and other current assets	(1,745)	1,616	(31,704)
Accounts payable	286,091	167,732	156,542
Accrued expenses and other current liabilities	(15,110)	(27,982)	3,800
Additions to unearned revenue	109,936	101,641	95,404
Amortization of previously unearned revenue	(106,886)	(111,740)	(135,466)
Interest payable	959	1,850	3,027
Net cash provided by operating activities	566,560	392,022	174,291
INVESTING ACTIVITIES:			
Sales and maturities of marketable securities and other investments	1,426,786	813,184	553,289
Purchases of marketable securities	(1,584,089)	(535,642)	(635,810)
Purchases of fixed assets, including internal-use software and website development	(89,133)	(45,963)	(39,163)
Proceeds from sale of subsidiary	—	5,072	—
Acquisition, net of cash acquired	(71,195)	—	—
Net cash (used in) provided by investing activities	(317,631)	236,651	(121,684)
FINANCING ACTIVITIES:			
Proceeds from exercises of stock options	60,109	163,322	121,689
Repayments of long-term debt, capital lease obligations	(157,401)	(495,308)	(14,795)
Net cash (used in) provided by financing activities	(97,292)	(331,986)	106,894
Foreign-currency effect on cash and cash equivalents	48,690	67,332	38,471
Net increase in cash and cash equivalents	200,327	364,019	197,972
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 1,302,600	$1,102,273	$ 738,254
SUPPLEMENTAL CASH FLOW INFORMATION:			
Fixed assets acquired under capital leases and other financing arrangements	$ 860	$ 2,677	$ 3,023
Cash paid for interest	107,604	119,947	111,589
Cash paid for income taxes	4,051	1,825	1,448

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,		
	2004	2003	2002
Net sales	$ 6,921,124	$ 5,263,699	$ 3,932,936
Cost of sales	5,319,127	4,006,531	2,940,318
Gross profit	1,601,997	1,257,168	992,618
Operating expenses:			
Fulfillment	590,397	477,032	392,467
Marketing	158,022	122,787	125,383
Technology and content	251,195	207,809	215,617
General and administrative	112,220	88,302	79,049
Stock-based compensation (1)	57,702	87,751	68,927
Other operating (income) expense	(7,964)	2,892	47,051
Total operating expenses	1,161,572	986,573	928,494
Income from operations	440,425	270,595	64,124
Interest income	28,197	21,955	23,687
Interest expense	(107,227)	(129,979)	(142,925)
Other (expense) income, net	(4,701)	6,514	4,923
Remeasurements and other	(824)	(130,097)	(100,442)
Total non-operating expense, net	(84,555)	(231,607)	(214,757)
Income (loss) before income taxes	355,870	38,988	(150,633)
Provision (benefit) for income taxes	(232,581)	3,706	(700)
Income (loss) before change in accounting principle	588,451	35,282	(149,933)
Cumulative effect of change in accounting principle	—	—	801
Net income (loss)	$ 588,451	$ 35,282	$ (149,132)
Basic earnings (loss) per share:			
Prior to cumulative effect of change in accounting principle	$ 1.45	$ 0.09	$ (0.40)
Cumulative effect of change in accounting principle	—	—	0.01
	$ 1.45	$ 0.09	$ (0.39)
Diluted earnings (loss) per share			
Prior to cumulative effect of change in accounting principle	$ 1.39	$ 0.08	$ (0.40)
Cumulative effect of change in accounting principle	—	—	0.01
	$ 1.39	$ 0.08	$ (0.39)
Weighted average shares used in computation of earnings (loss) per share:			
Basic	405,926	395,479	378,363
Diluted	424,757	419,352	378,363

(1) Components of stock-based compensation:

Fulfillment	$ 10,073	$ 17,960	$ 12,126
Marketing	4,253	4,968	4,239
Technology and content	31,781	49,555	35,926
General and administrative	11,595	15,268	16,636
	$ 57,702	$ 87,751	$ 68,927

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	December 31,	
	2004	2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,302,600	$ 1,102,273
Marketable securities	476,599	292,550
Cash, cash equivalents, and marketable securities	1,779,199	1,394,823
Inventories	479,709	293,917
Current deferred tax assets	81,388	596
Accounts receivable, net and other current assets	199,100	131,473
Total current assets	2,539,396	1,820,809
Fixed assets, net	246,156	224,285
Long-term deferred tax assets	281,757	4,142
Goodwill	138,999	69,121
Other assets	42,200	43,676
Total assets	$ 3,248,508	$ 2,162,033
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 1,141,733	$ 819,811
Accrued expenses and other current liabilities	361,128	317,730
Unearned revenue	41,099	37,844
Interest payable	74,059	73,100
Current portion of long-term debt and other	2,381	4,216
Total current liabilities	1,620,400	1,252,701
Long-term debt and other	1,855,319	1,945,439
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, $0.01 par value:		
Authorized shares—500,000		
Issued and outstanding shares—none	—	—
Common stock, $0.01 par value:		
Authorized shares—5,000,000		
Issued and outstanding shares—409,711 and 403,354 shares	4,097	4,034
Additional paid-in capital	2,124,598	1,899,398
Deferred stock-based compensation	(2,038)	(2,850)
Accumulated other comprehensive income	32,109	37,739
Accumulated deficit	(2,385,977)	(2,974,428)
Total stockholders' deficit	(227,211)	(1,036,107)
Total liabilities and stockholders' deficit	$ 3,248,508	$ 2,162,033

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(in thousands)

	Common Stock		Additional Paid-In Capital	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount					
Balance at December 31, 2001	373,218	$ 3,732	$1,462,769	$ (9,853)	$ (36,070)	$ (2,860,578)	$ (1,440,000)
Net loss	—	—	—	—	—	(149,132)	(149,132)
Foreign currency translation gains, net	—	—	—	—	16,910	—	16,910
Increase of net unrealized gains on available-for-sale securities	—	—	—	—	20,294	—	20,294
Net increase in unrealized losses on terminated Euro Currency Swap	—	—	—	—	8,528	—	8,528
Comprehensive loss	—	—	—	—	—	—	(103,400)
Exercise of common stock options, net	14,728	147	121,542	—	—	—	121,689
Deferred stock-based compensation, net of adjustments	(40)	—	1,569	(2,828)	—	—	(1,259)
Income tax benefit on excess stock-based compensation	—	—	23	—	—	—	23
Amortization of deferred stock-based compensation	—	—	—	6,090	—	—	6,090
Stock compensation – restricted stock units	—	—	3,913	—	—	—	3,913
Stock compensation – variable accounting	—	—	60,130	—	—	—	60,130
Balance at December 31, 2002	387,906	3,879	1,649,946	(6,591)	9,662	(3,009,710)	(1,352,814)
Net income	—	—	—	—	—	35,282	35,282
Foreign currency translation gains, net	—	—	—	—	14,707	—	14,707
Increase of net unrealized gains on available-for-sale securities	—	—	—	—	2,482	—	2,482
Net increase in unrealized losses on terminated Euro Currency Swap	—	—	—	—	10,888	—	10,888
Comprehensive income	—	—	—	—	—	—	63,359
Exercise of common stock options, net and vesting of restricted stock	15,413	155	163,195	—	—	—	163,350
Notes converted	1	—	47	—	—	—	47
Income tax benefit on excess stock-based compensation	—	—	2,200	—	—	—	2,200
Amortization of deferred stock-based compensation	—	—	—	3,741	—	—	3,741
Issuance of common stock – employee benefit plan	34	—	1,444	—	—	—	1,444
Stock compensation – restricted stock units	—	—	30,691	—	—	—	30,691
Stock compensation – variable accounting	—	—	51,875	—	—	—	51,875
Balance at December 31, 2003	403,354	4,034	1,899,398	(2,850)	37,739	(2,974,428)	(1,036,107)
Net income	—	—	—	—	—	588,451	588,451
Foreign currency translation gains, net	—	—	—	—	(502)	—	(502)
Decline of unrealized gains on available-for-sale securities, net of tax effect	—	—	—	—	(10,986)	—	(10,986)
Amortization of unrealized loss on terminated Euro Currency Swap, net of tax	—	—	—	—	5,858	—	5,858
Comprehensive income	—	—	—	—	—	—	582,821
Exercise of common stock options, net and vesting of restricted stock	6,290	62	59,943	—	—	—	60,005
Income tax benefit on excess stock-based compensation	—	—	107,251	—	—	—	107,251
Deferred stock-based compensation, net	—	—	1,799	812	—	—	2,611
Issuance of common stock – employee benefit plan	67	1	3,005	—	—	—	3,006
Stock compensation – restricted stock units	—	—	48,625	—	—	—	48,625
Stock compensation – variable accounting	—	—	4,577	—	—	—	4,577
Balance at December 31, 2004	409,711	$ 4,097	$2,124,598	$ (2,038)	$ 32,109	$ (2,385,977)	$ (227,211)

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—DESCRIPTION OF BUSINESS AND ACCOUNTING POLICIES

Description of Business

Amazon.com, Inc., a Fortune 500 company, opened its virtual doors on the World Wide Web in July 1995. We seek to be Earth's most customer-centric company, where customers can find and discover anything they might want to buy online, and endeavor to offer customers the lowest possible prices. We and third-party sellers offer millions of new, used, refurbished, and collectible items, in dozens of product categories.

Amazon.com and its affiliates operate seven retail websites: *www.amazon.com, www.amazon.co.uk, www.amazon.de, www.amazon.co.jp, www.amazon.fr, www.amazon.ca,* and *www.joyo.com*. We have organized our operations into two principal segments: North America and International. The North America segment includes the operating results of *www.amazon.com* and *www.amazon.ca*. The International segment includes the operating results of *www.amazon.co.uk, www.amazon.de, www.amazon.fr, www.amazon.co.jp,* and *www.joyo.com*. In addition, we operate *www.a9.com* and *www.alexa.com* that enable search and navigation, and *www.imdb.com*, a comprehensive movie database.

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 assets and liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, inventory valuation, depreciable lives, sales returns, receivables valuation, restructuring-related liabilities, incentive discount offers, valuation of investments, acquired intangibles, taxes, and contingencies. Actual results could differ materially from those estimates.

Business Acquisition

In September 2004, we acquired all of the outstanding shares of Joyo.com Limited ("Joyo.com"), a British Virgin Islands company that operates an Internet retail website in the People's Republic of China ("PRC") in cooperation with a PRC subsidiary and PRC affiliates, at a purchase price of $75 million, including a cash payment of $71 million (net of cash acquired), the assumption of employee stock options, and transaction-related costs. Acquired intangibles were $6 million with estimated useful lives of between one and four years. The excess of purchase price over the fair value of the net assets acquired was $70 million and is classified as "Goodwill" on the consolidated balance sheets. The results of operations of Joyo.com have been included in our consolidated results from the acquisition date forward. The effect on consolidated net sales and operating income was not significant for 2004.

Joyo.com does not own any capital stock of the PRC affiliates, but is the primary beneficiary of future losses or profits through contractual rights. As a result, we consolidate the results of the PRC affiliates in accordance with FIN 46R, "Consolidation of Variable Interest Entities." The net assets and operating results for the PRC affiliates were not significant.

The intrinsic value of the unvested employee stock options that were assumed in connection with the Joyo.com acquisition is recorded to "Deferred stock-based compensation" on the consolidated balance sheets and

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

will be expensed over the remaining service period. Amortization of these amounts is classified in "Stock-based compensation" on the consolidated statements of operations.

Cash and Cash Equivalents

We classify all highly liquid instruments with a remaining maturity of three months or less at the time of purchase as cash equivalents.

Allowance for Doubtful Accounts

We estimate losses on receivables based on known troubled accounts, if any, and historical experience of losses incurred.

Accounting Change

Effective January 1, 2002, we prospectively changed our inventory costing method from the specific identification method to the first-in-first-out ("FIFO") method of accounting. This change resulted in a cumulative increase in inventory of $0.8 million, with a corresponding amount recorded to "Cumulative effect of change in accounting principle" on the consolidated statements of operations. We received a letter of preferability for this change in inventory costing from our independent auditors.

Inventories

Inventories, consisting of products available for sale, are accounted for using the 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 Merchants@ and Merchant.com programs. In those arrangements, as well as all other product sales by third parties, the third party maintains ownership of the related products.

Accounts Receivable, Net and Other Current Assets

Included in "Accounts receivable, net and other current assets" are prepaid expenses of $12 million and $6 million at December 31, 2004 and 2003, representing advance payments for insurance, licenses, and other miscellaneous expenses.

Asset Retirement Obligations

In accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations,* we establish assets and liabilities for the present value of estimated future costs to return certain of our leased facilities to their original condition. Such assets are depreciated over the lease period into operating expense, and the recorded liabilities are accreted to the future value of the estimated restoration costs. Such amounts are not significant.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Fixed Assets

Fixed assets are stated at cost less accumulated depreciation, which includes the amortization of assets recorded under capital leases. Fixed assets, including assets purchased under capital leases, are depreciated on a straight-line basis over the estimated useful lives of the assets (generally two to ten years). Depreciation expense is classified within the corresponding operating expense categories on the consolidated statements of operations.

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. In accordance with SOP 98-1, *"Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,"* we capitalize costs incurred during the application development stage related to the development 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.

Leases

We account for our lease agreements pursuant to SFAS No 13, "*Accounting for Leases*," which categorizes leases at their inception as either operating or capital leases depending on certain defined criteria. On certain of our lease agreements, we may receive rent holidays and other incentives. We recognize lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays that defer the commencement date of required payments. Additionally, incentives we receive are treated as a reduction of our costs over the term of the agreement. Leasehold improvements are capitalized at cost and amortized over the lesser of their expected useful life and the life of the lease, without assuming renewal features, if any, are exercised.

Goodwill

We evaluate goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using discounted projected cash flows. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. We conduct our annual impairment test as of October 1 of each year, and have determined there to be no impairment in 2004 or 2003. There were no events or circumstances from the date of our assessment through December 31, 2004 that would impact this assessment.

Additionally, during 2004, we acquired $70 million of goodwill related to our acquisition of Joyo.com.

Other Assets

Included in "Other assets" on our consolidated balance sheets are amounts primarily related to deferred issuance charges on our long-term debt, which are amortized over the life of the debt; certain equity investments; and intangible assets, net of amortization. At December 31, 2004, and 2003, deferred issuance charges were $19 million, and $25 million; equity investments were $15 million and $15 million; and intangibles, net of amortization, were $5 million, and $1 million.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Other intangibles, included within "Other assets," consist of the following:

	December 31,					
	2004			2003		
	Other Intangibles, Gross (1)	Accumulated Amortization (1)	Other Intangibles, Net (2)	Other Intangibles, Gross (1)	Accumulated Amortization (1)	Other Intangibles, Net
	(in thousands)					
Marketing-related	$ 3,204	$ (304)	$ 2,900	$ 5,617	$ (5,326)	$ 291
Contract-based	2,503	(196)	2,307	—	—	—
Technology-based	220	(66)	154	4,386	(4,360)	26
Customer-related	—	—	—	2,021	(1,820)	201
Other intangibles	$ 5,927	$ (566)	$ 5,361	$ 12,024	$ (11,506)	$ 518

(1) Excludes the original cost and accumulated amortization of fully-amortized intangibles.
(2) The net carrying amount of intangible assets at December 31, 2004 is scheduled to be fully amortized over the next four years as follows: $2 million in 2005; $1 million in 2006; $1 million in 2007; and $1 million in 2008. The weighted-average amortization period is 3.4 years based on useful life assumptions between one and four years.

The increase in net other intangibles in 2004 primarily relates to the acquisition of Joyo.com.

Investments

The initial carrying cost of our investments is the price we paid. Investments are accounted for using the equity method of accounting if the investment gives us the ability to exercise significant influence, but not control, over an investee. We classify our investments in equity-method investees on the consolidated balance sheets as "Other assets" and our share of the investees' earnings or losses as "Remeasurements and other" on the consolidated statements of operations. Losses from equity-method investees were not significant for 2004, 2003, and 2002. We do not hold over 20% interest in any of our investees as of December 31, 2004 or 2003.

All other equity investments, which consist of investments for which we do not have the ability to exercise significant influence, are accounted for under the cost method. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value, distributions of earnings, and additional investments. For public companies that have readily determinable fair values, we classify our equity investments as available-for-sale and, accordingly, record these investments at their fair values with unrealized gains and losses, net of tax, included in "Accumulated other comprehensive income (loss)," a separate component of Stockholders' Deficit.

We generally invest our excess cash in "A" rated or higher short- to intermediate-term fixed income securities and money market mutual funds. Such investments are included in "Cash and cash equivalents," or "Marketable securities" on the accompanying consolidated balance sheets and are reported at fair value with unrealized gains and losses included in "Accumulated other comprehensive income (loss)." The weighted average method is used to determine the cost of Euro-denominated securities sold and the specific identification method is used to determine the cost of all other securities.

We periodically evaluate whether declines in fair values of our investments are other-than-temporary. This evaluation consists of a review of qualitative and quantitative factors, including quoted market prices, if available; recent financial results and operating trends; other publicly available information; implied values from

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

any recent financing rounds; or other conditions that bear on the value of our investments. At December 31, 2004, gross unrealized losses on our marketable securities were $2 million and were determined to be temporary based on our assessment of the qualitative and quantitative factors discussed above.

Long-Lived Assets

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets is not recoverable.

For long-lived assets used in operations, impairment losses are only recorded if the asset's carrying amount is not recoverable through its undiscounted, probability-weighted cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value.

Long-lived assets are considered held for sale when certain criteria are met, including: management has committed to a plan to sell the asset, the asset is available for sale in its immediate condition, and the sale is probable within one year of the reporting date. Assets held for sale are reported at the lower of cost or fair value less costs to sell. Assets held for sale were not significant at December 31, 2004 or 2003.

Unearned Revenue

Unearned revenue is recorded when payments are received in advance of performing our service obligations and is amortized ratably over the service period. An example of unearned revenue is cash received from third parties under certain Merchants@ agreements for which we provide the services over time.

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 11—"Income Taxes."

SFAS 109, "*Accounting for Income Taxes,*" requires 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.

Classification of deferred tax assets between current and long-term categories is based on the expected timing of realization, and the valuation allowance is allocated on a pro-rata basis.

Revenue

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 outlined in Emerging Issues Task Force ("EITF") Issue No. 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 primarily 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 fixed 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 sales to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss upon our delivery to the carrier, which is commonly referred to as "F.O.B. Shipping Point." Return allowances, which reduce product revenue, are estimated using historical experience. Amounts paid in advance for subscription services, including amounts received for online DVD rentals and other membership programs, are deferred and recognized as revenue on a straight-line basis 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 presented as a net amount in "Net sales."

Commissions and per-unit fees received from third-party sellers and similar amounts earned through our Merchant.com program are recognized when the item is sold by the third-party seller and our collectibility is reasonably assured. We record an allowance for estimated refunds on such commissions using historical experience.

Outbound shipping charges to customers are included in "Net sales" and, excluding amounts earned from third-party sellers where we don't provide fulfillment services, amounted to $420 million, $372 million, and $365 million for 2004, 2003, and 2002.

Cost of Sales

Cost of sales consists of the purchase price of consumer products sold by us, inbound and outbound shipping charges, packaging supplies, and costs incurred in operating and staffing our fulfillment and customer service centers on behalf of other businesses, such as Toysrus.com, Inc. and Target Corporation. Credit card fees and bad debt costs, including those associated with our guarantee for certain third-party seller transactions, are classified in "Fulfillment" on the consolidated statements of operations.

Outbound shipping-related costs totaled $617 million, $508 million, and $404 million for the years ended December 31, 2004, 2003, and 2002.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Vendor Agreements

We have agreements to receive cash consideration from certain of our vendors, including rebates and cooperative marketing reimbursements. We generally presume amounts received from our vendors are a reduction of the prices we pay for their products and, therefore, we reflect such amounts as either a reduction of "Cost of sales" on our consolidated statements of operations, or, if the product inventory is still on hand at the reporting date, it is reflected as a reduction of "Inventories" on our consolidated balance sheets. Vendor rebates are typically dependent upon reaching minimum purchase thresholds. We evaluate the likelihood of reaching purchase thresholds using past experience and current year forecasts. When rebates can be reasonably estimated, we record a portion of the rebate as we make progress towards the purchase threshold.

When we receive direct reimbursements for costs incurred by us in advertising the vendor's product or service, the amount we receive is recorded as an offset to "Marketing" on our consolidated statements of operations.

Fulfillment

Fulfillment costs represent those costs incurred in operating and staffing our fulfillment and customer service centers, including costs attributable to buying, receiving, inspecting, and warehousing inventories; picking, packaging, and preparing customer orders for shipment; credit card fees and bad debt costs, including costs associated with our guarantee for certain third-party seller transactions; and responding to inquiries from customers. Fulfillment costs also include amounts paid to third-parties that assist us in fulfillment and customer service operations. Certain of our fulfillment-related costs that are incurred on behalf of other businesses, such as Toysrus.com, Inc. and Target Corporation, are classified as cost of sales rather than fulfillment.

Marketing

Marketing costs consist of primarily online advertising, including through our Associates and Syndicated Stores programs, sponsored search, portal advertising, e-mail campaigns, and other initiatives. We pay commissions to participants in our Associates program when their customer referrals result in product sales and classify such costs as "Marketing" on our consolidated statements of operations.

We also participate in cooperative advertising arrangements with certain of our vendors, and other third parties. To the extent co-operative marketing reimbursements decline in future periods, we may incur additional expenses to continue certain promotions or elect to reduce or discontinue them.

Marketing expenses also consist of public relations expenditures; payroll and related expenses for personnel engaged in marketing, business development, and selling activities; and to a lesser extent, traditional advertising such as newspaper inserts.

Advertising and other promotional costs, which consist primarily of online advertising, are expensed as incurred, and were $141 million, $109 million, and $114 million in 2004, 2003, and 2002. Prepaid advertising costs were not significant at December 31, 2004 and 2003.

Technology and Content

Technology and content expenses consist principally of payroll and related expenses for employees involved in development of our websites, including application development, editorial content, merchandising selection,

systems and telecommunications support, costs associated with the systems and telecommunications infrastructure, and costs of acquired content.

Technology and content costs are expensed as incurred, except for certain costs relating to the development of internal-use software and website development, including software used to upgrade and enhance our websites and processes supporting our business, which are capitalized and depreciated over two years. During 2004, 2003, and 2002 we capitalized $44 million, $30 million, and $25 million of costs associated with development of internal-use software, which is offset by amortization of previously capitalized amounts of $30 million, $24 million, and $26 million. Fixed assets associated with capitalized internal-use software, content, and website development, net of accumulated depreciation, were $47 million and $33 million at December 31, 2004 and 2003.

General and Administrative

General and administrative expenses consist of payroll and related expenses for employees involved in general corporate functions, including accounting, finance, tax, legal, and human relations, among others; costs associated with use by these functions of facilities and equipment, such as depreciation expense and rent; professional fees and litigation costs; and other general corporate costs.

Stock-Based Compensation

On October 13, 2004, the Financial Accounting Standards Board reached a consensus on the effective date for SFAS No. 123R, *Share-Based Payment*. SFAS 123R requires us to measure compensation cost for all outstanding unvested share-based awards at fair value beginning on July 1, 2005, however we will early-adopt the provisions of SFAS 123R with an implementation date of January 1, 2005. The adoption of this standard will not affect the stock-based compensation associated with our restricted stock units which are already recorded at fair value on the date of grant and recognized over the service period, and will result in the recognition of stock-based compensation in future periods for remaining unvested stock options as of the effective date. As of the implementation date of this standard, we will no longer have employee stock awards subject to variable accounting treatment. We estimate that stock-based compensation will be approximately $115 million for 2005.

We generally have three categories of stock-based awards: restricted stock units, restricted stock, and stock options. Through December 31, 2004, we accounted for stock-based awards under the intrinsic value method, which follows the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. The intrinsic value method of accounting results in compensation expense to the extent option exercise prices are set below market prices on the date of grant. Also, to the extent stock awards were granted subsequent to December 31, 2002, or were subject to an exchange offer, other modifications, or performance criteria, such awards were subject to variable accounting treatment.

We have a 401(k) savings plan covering substantially all of our U.S. employees, and eligible employees may contribute through payroll deductions. Beginning in April 2003, we began matching a portion of employee contributions using our common stock. Stock-based compensation includes matching contributions under our 401(k) program.

We record the employer portion of payroll tax expense, a cash tax, resulting from exercises of stock options and vesting of restricted stock in "Fulfillment," "Marketing," "Technology and content," and "General and administrative" on our consolidated statements of operations and do not include such expenses in "Stock-based compensation."

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Stock-based compensation consisted of the following:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Stock awards—variable accounting (1)	$ 4,577	$51,875	$60,130
Fixed accounting (2):			
Restricted stock units (3)	48,625	30,691	3,913
Restricted stock (4)	4,500	5,185	4,884
Total stock-based compensation	$57,702	$87,751	$68,927

(1) Variable accounting treatment results in expense or contra-expense recognition using the cumulative expense method, calculated based on the quoted price of our common stock and vesting schedules of underlying awards. To the extent stock options are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to "Stock-based compensation."
(2) The fair value of awards is determined at grant date based on the number of shares granted and the quoted price of our common stock. Such value is recognized as expense over the service period using the accelerated method under FIN No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.* To the extent awards are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to stock-based compensation.
(3) Since October 2002, we have awarded restricted stock units as our primary form of stock-based compensation.
(4) Includes expense associated with matching contributions of 0.07 million and 0.03 million shares of our common stock under our 401(k) savings plan during 2004 and 2003. No matching contributions were made in 2002.

Outstanding stock awards were as follows:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Stock options (1)(2)	18,371	24,961	42,005
Restricted stock units (3)	6,396	4,410	2,935
Outstanding stock awards, excluded from common stock outstanding	24,767	29,371	44,940
Restricted stock (4)	490	790	1,011
Total outstanding stock awards	25,257	30,161	45,951

(1) The weighted average per share exercise price was $12.98, $12.46, and $11.91 in 2004, 2003, and 2002.
(2) Includes 0.9 million, 1.1 million, and 4.7 million options in 2004, 2003, and 2002 subject to variable accounting treatment.
(3) Includes 0.3 million restricted stock units subject to variable accounting treatment in 2004, 2003, and 2002.
(4) Included in issued and outstanding common stock.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes relevant information as if the fair value recognition provisions of SFAS No. 123, *Accounting for Stock Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, had been applied to all stock-based awards (in thousands, except per share data):

	Year Ended December 31,		
	2004	2003	2002
Net income (loss)—as reported	$588,451	$ 35,282	$(149,132)
Add: Stock-based compensation, as reported	57,702	87,751	68,927
Deduct: Total stock-based compensation determined under fair value based method for all awards	(81,166)	(94,525)	(148,083)
Net income (loss)—SFAS No. 123 adjusted	$564,987	$ 28,508	$(228,288)
Basic earnings (loss) per share—as reported	$ 1.45	$ 0.09	$ (0.39)
Basic earnings (loss) per share—SFAS No. 123 adjusted	1.39	0.07	(0.60)
Diluted earnings (loss) per share—as reported	1.39	0.08	(0.39)
Diluted earnings (loss) per share—SFAS No. 123 adjusted	1.33	0.07	(0.60)

The fair value for each stock option granted was estimated at the date of grant using a Black-Scholes option-pricing model, assuming no dividends and the following assumptions:

	Year Ended December 31,		
	2004	2003	2002
Average risk-free interest rate	2.9%	2.5%	3.1%
Average expected life (in years)	3.3	3.3	3.3
Volatility	57.9%	77.7%	81.8%

Restructuring Estimates

Restructuring-related liabilities include estimates for, among other things, anticipated disposition of lease obligations. Key variables in determining such estimates include anticipated timing of sublease rentals, estimates of sublease rental payment amounts and tenant improvement costs, and estimates for brokerage and other related costs. We periodically evaluate and, if necessary, adjust our estimates based on currently-available information. Additionally, we may determine that certain of the office space previously vacated as part of our 2001 restructuring, which we have been unable to sublease due to poor real estate market conditions, may be necessary for our future needs. To the extent we elect to utilize this office space we will adjust our restructuring-related liability and classify future payments to the corresponding operating expense categories on the consolidated statements of operations. See "Note 8—Other Operating Expense (Income)."

Foreign Currency

We have the following internationally-focused websites: *www.amazon.co.uk, www.amazon.de, www.amazon.fr, www.amazon.co.jp, www.amazon.ca*, and *www.joyo.com*. Net sales generated from internationally-focused websites, as well as most of the related expenses directly incurred from those operations, are denominated in the functional currencies of the resident countries. Additionally, the functional currency of our subsidiaries that either operate or support *www.amazon.co.uk, www.amazon.de, www.amazon.fr, www.amazon.co.jp, www.amazon.ca,* and *www.joyo.com* is the same as the local currency of the United Kingdom, Germany, France, Japan, Canada, and China. Assets and liabilities of these subsidiaries are translated into U.S. Dollars at period-end exchange rates, and revenues and expenses are translated at average rates

prevailing throughout the period. Translation adjustments are included in "Accumulated other comprehensive income (loss)," a separate component of stockholders' deficit and in the "Effect of exchange-rate changes on cash and cash equivalents," on the consolidated statements of cash flows. Transaction gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved are included in "Other income (expense), net" on the consolidated statements of operations. See "Note 9—Other Income (Expense), Net."

A provision of SFAS No. 52, *Foreign Currency Translation*, requires that gains and losses arising from intercompany foreign currency transactions considered long-term investments, where settlement is not planned or anticipated in the foreseeable future, be excluded in the determination of net income. Our international operations are financed, in part, by the U.S. parent company. In periods ending prior to the fourth quarter of 2003, currency adjustments for these intercompany balances were recorded to stockholders' deficit as translation adjustments and not included in the determination of net income because we intended to permanently invest such amounts. During the fourth quarter of 2003, we made the decision that these amounts would be repaid among the entities and, accordingly, upon consolidation, any exchange gain or loss arising from remeasurements of intercompany balances is required to be recorded in the determination of net income. In accordance with SFAS No. 52, currency adjustments arising before the fourth quarter of 2003 continue to be included as a component of "Accumulated other comprehensive income" on our consolidated balance sheets. In connection with the remeasurement of intercompany balances, we recorded gains of $41 million and $36 million in 2004 and 2003. During 2004, $210 million was repaid among the entities.

Derivative Financial Instruments

During the second quarter of 2003, we terminated our Euro Currency Swap that previously was designated as a cash flow hedge of a portion of the 6.875% PEACS principal and interest. See "Note 4—Long-Term Debt and Other."

We hold warrants to purchase equity securities of other companies that are derivative financial instruments, classified in "Other assets" on the consolidated balance sheets. We do not designate our warrants as hedging instruments; accordingly, gains or losses resulting from changes in fair value are recognized on the consolidated statements of operations, "Remeasurements and other," in the period of change. We determine the fair value of our warrants through option-pricing models using current market price and volatility assumptions, including public-company market comparables for our private-company warrants.

Earnings (Loss) per Share

In accordance with SFAS No. 128, *Earnings per Share*, the weighted-average number of shares used to calculate basic earnings (loss) per share excludes shares of restricted stock since they are subject to repurchase or forfeiture.

For periods when we have net income, the dilutive effect of outstanding stock awards, including restricted stock, is included in the calculation of diluted earnings per share using the treasury stock method for assumed proceeds, if any. For periods when we have a net loss, the effect of outstanding stock awards, including restricted stock, is antidilutive and therefore excluded from the calculation of diluted loss per share.

Stock issuable upon conversion of our convertible debt instruments is excluded from the calculation of diluted earnings per share as its effect is antidilutive. See "Note 4—Long-Term Debt and Other."

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table shows the calculation of diluted shares (in thousands):

	Year Ended December 31,		
	2004	2003	2002
Weighted average shares outstanding	406,480	396,389	379,494
Weighted average shares of restricted stock	(554)	(910)	(1,131)
Shares used in computation of basic earnings (loss) per share	405,926	395,479	378,363
Total dilutive effect of outstanding stock awards (1)	18,831	23,873	—
Shares used in computation of diluted earnings (loss) per share	424,757	419,352	378,363

(1) The effect of outstanding stock awards, including restricted stock, is antidilutive for periods that we have a net loss and, accordingly, is excluded from the calculation of diluted loss per share in those periods. The dilutive effect of stock awards and restricted stock is included in the calculation of weighted average shares, using the treasury stock method, for periods that we have net income.

Recent Accounting Pronouncements

We will be implementing the provisions of SFAS 123R, *"Share-Based Payment,"* on January 1, 2005. See "Stock-based compensation" of this Note 1 for additional discussion, including the anticipated effect on our financial results of adopting this standard.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Note 2—CASH, CASH EQUIVALENTS, AND MARKETABLE SECURITIES

The following tables summarize, by major security type, our cash and marketable securities (in thousands):

	December 31, 2004			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (1)	Estimated Fair Value
Cash	$ 407,906	$ —	$ —	$ 407,906
Cash equivalents pledged as collateral (See Note 5)	9,682	—	—	9,682
Commercial paper and other cash equivalents	882,618	2,394	—	885,012
Total cash and cash equivalents	1,300,206	2,394	—	1,302,600
Asset-backed and agency securities	293,435	2,311	(908)	294,838
U.S. Treasury notes and bonds	141,858	3	(1,133)	140,728
Corporate notes and bonds	29,488	—	(189)	29,299
Equity securities and other	499	11,235	—	11,734
Marketable securities	465,280	13,549	(2,230)	476,599
Total cash, cash equivalents, and marketable securities (2)	$1,765,486	$ 15,943	$ (2,230)	$1,779,199

(1) The fair value of investments with loss positions was $483 million. We evaluated the nature of these investments, which are primarily U.S. Treasury Notes, the duration of the impairments (substantially all less than twelve months), and concluded that such amounts were not "other-than-temporary" as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(2) Includes investments in foreign currencies of $970 million, principally Euros, British Pounds, and Yen.

	December 31, 2003			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (1)	Estimated Fair Value
Cash	$ 427,306	$ —	$ —	$ 427,306
Commercial paper and other cash equivalents	669,403	5,564	—	674,967
Total cash and cash equivalents	1,096,709	5,564	—	1,102,273
U.S. Treasury notes and bonds	145,641	286	(149)	145,778
Asset-backed and agency securities	85,403	302	(13)	85,692
Certificates of deposit	20,026	7,369	—	27,395
Corporate notes and bonds	24,866	131	—	24,997
Equity securities and other	2,454	6,234	—	8,688
Marketable securities	278,390	14,322	(162)	292,550
Total cash, cash equivalents, and marketable securities (2)	$1,375,099	$ 19,886	$ (162)	$1,394,823

(1) The fair value of investments with loss positions was $100 million. We evaluated the nature of these investments, which are primarily U.S. Treasury Notes, the duration of the impairments (all less than twelve months), and the amount of the impairments relative to the underlying portfolio and concluded that such amounts were not "other-than-temporary" as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

(2) Includes investments in foreign currencies of $764 million, principally Euros, British Pounds, and Yen.

The following table summarizes contractual maturities of our cash equivalent and marketable fixed-income securities as of December 31, 2004 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	$ 874,774	$ 877,083
Due after one year through three years	160,965	159,330
Asset-backed and agency securities with various maturities	321,841	323,245
	$ 1,357,580	$ 1,359,658

Gross gains of $1 million, $17 million, and $9 million and gross losses of $1 million, $1 million and $1 million were realized on sales of available-for-sale marketable securities for 2004, 2003, and 2002.

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 and for real estate lease agreements. See "Note 5—Commitments and Contingencies."

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 3—FIXED ASSETS

Fixed assets, at cost, consist of the following (in thousands):

	December 31,	
	2004	2003
Gross Fixed Assets (1):		
Fulfillment and customer service (2)	$ 263,002	$ 241,497
Technology infrastructure	38,408	25,592
Internal-use software, content, and website development	79,026	57,413
Other corporate assets	42,527	47,236
Gross fixed assets	422,963	371,738
Accumulated Depreciation (1):		
Fulfillment and customer service	105,939	84,987
Technology infrastructure	15,086	13,167
Internal-use software, content, and website development	31,866	24,530
Other corporate assets	23,916	24,769
Total accumulated depreciation	176,807	147,453
Total fixed assets, net	$ 246,156	$ 224,285

(1) Excludes the original cost and accumulated depreciation of fully-depreciated assets which were $216 million and $171 million at December 31, 2004 and 2003.

(2) Includes our online rental DVD catalog.

Depreciation expense on fixed assets was $75 million, $70 million, and $77 million, which includes amortization of fixed assets acquired under capital lease obligations of $5 million, $7 million and $7 million for 2004, 2003, and 2002. Gross assets remaining under capital leases were $4 million and $5 million at December 31, 2004 and 2003. Accumulated depreciation associated with capital leases was $2 million and $3 million at December 31, 2004 and 2003.

Note 4—LONG-TERM DEBT AND OTHER

Our long-term debt and other long-term liabilities are summarized as follows (in thousands):

	December 31,	
	2004	2003
	(in thousands)	
4.75% Convertible Subordinated Notes due February 2009	$ 899,760	$ 1,049,760
6.875% PEACS due February 2010	935,086	869,711
Long-term restructuring liabilities (see Note 8)	7,922	20,066
Capital lease obligations	1,744	2,717
Other long-term debt	13,188	7,401
	1,857,700	1,949,655
Less current portion of capital lease obligations	(1,229)	(1,558)
Less current portion of other long-term debt	(1,152)	(2,658)
Total long-term debt and other	$ 1,855,319	$ 1,945,439

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

6.875% PEACS

In February 2000, we completed an offering of 690 million Euros of 6.875% PEACS due 2010. The 6.875% PEACS are convertible, at the holder's option, into our common stock at a conversion price of 84.883 Euros per share. The U.S. Dollar equivalent principal, interest, and conversion price fluctuate based on the Euro/U.S. Dollar exchange ratio. Interest on the 6.875% PEACS is payable annually in arrears in February of each year. The 6.875% PEACS are unsecured and are subordinated to any existing and future senior indebtedness. The 6.875% PEACS rank equally with our outstanding 4.75% Convertible Subordinated Notes. 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. No premium payment is required for early redemption.

Upon the occurrence of a "fundamental change" prior to the maturity of the 6.875% PEACS, each holder thereof has the right to require us to redeem all or any part of such holder's 6.875% PEACS at a price equal to 100% of the principal amount of the notes being redeemed, together with accrued interest. As defined in the indenture, a "fundamental change" is the occurrence of certain types of transactions in which our stockholders do not receive publicly-traded securities.

The indenture governing the 6.875% PEACS contains certain affirmative covenants for us, including making principal and interest payments when due, maintaining our corporate existence and properties, and paying taxes and other claims in a timely manner. We were in compliance with these covenants through December 31, 2004.

During the second quarter of 2003, we terminated our Euro Currency Swap that previously was designated as a cash flow hedge of a portion of the 6.875% PEACS' principal and interest. Although neither party made cash payments to terminate the agreement, we recorded a non-cash loss of $6 million to "Remeasurements and other" representing the remaining basis in our swap asset. At December 31, 2004, the remaining cumulative unrealized loss associated with our Euro Currency Swap, recorded to "Accumulated other comprehensive income," was $7 million, net of tax effects. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, this accumulated loss will be amortized to "Remeasurements and other" over the life of the 6.875% PEACS. No net gains or losses resulting from hedge ineffectiveness were recognized in our results of operations during the year ended December 31, 2002. If we redeem or otherwise restructure our 6.875% PEACS prior to maturity in 2010, any remaining cumulative unrealized loss associated with the Euro Currency Swap will be recorded as a charge to "Remeasurements and other."

Based upon quoted market prices, the fair value of the 6.875% PEACS was $936 million and $870 million as of December 31, 2004 and 2003.

4.75% Convertible Subordinated Notes

On February 3, 1999, we completed an offering of $1.25 billion of 4.75% Convertible Subordinated Notes due February 2009. 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. Interest on the 4.75% Convertible Subordinated Notes is payable semi-annually in arrears in February and August of each year. The 4.75% Convertible Subordinated Notes are unsecured and are subordinated to any existing and future senior indebtedness as defined in the indenture governing the 4.75% Convertible Subordinated Notes. The 4.75% Convertible Subordinated Notes rank equally with our outstanding 6.875% PEACS. We have the right to redeem the 4.75% Convertible Subordinated Notes, in whole or in part, by paying the principal plus a redemption premium, plus any accrued and unpaid interest. At December 31, 2004, the redemption premium was 2.375% of the principal, and decreased to 1.900% on February 1, 2005 and will decrease by an additional 47.5 basis points annually until maturity.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Upon the occurrence of a "fundamental change" prior to the maturity of the 4.75% Convertible Subordinated Notes, each holder thereof has the right to require us to redeem all or any part of such holder's 4.75% Convertible Subordinated Notes at a price equal to 100% of the principal amount of the notes being redeemed, together with accrued interest. As defined in the indenture, a "fundamental change" is the occurrence of certain types of transactions in which our stockholders do not receive publicly-traded securities.

The indenture governing the 4.75% Convertible Subordinated Notes contains certain affirmative covenants for us, including making principal and interest payments when due, maintaining our corporate existence and properties, and paying taxes and other claims in a timely manner. We were in compliance with these covenants through December 31, 2004.

In 2004 and 2003, we redeemed aggregate principal amounts of $150 million and $200 million of our outstanding 4.75% Convertible Subordinated Notes. As provided in the underlying indenture, the redemption prices of $154 million and $206 million represented $4 million (2.375%) and $6 million (2.85%) premiums over the face amount of the redeemed notes. We recorded charges in 2004 and 2003, classified in "Remeasurements and other," of $6 million and $9 million related to these redemptions, consisting of premiums of $4 million and $6 million and unamortized deferred issuance costs of $2 million and $3 million.

Based upon quoted market prices, the fair value of our 4.75% Convertible Subordinated Notes as of December 31, 2004 and 2003 was $907 million (principal balance of $900 million) and $1.06 billion (principal balance of $1.05 billion).

Note 5—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 $55 million, $52 million, and $56 million for 2004, 2003, and 2002.

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following summarizes our principal contractual commitments, excluding open orders for inventory purchases that support normal operations, as of December 31, 2004:

	2005	2006	2007	2008	2009	Thereafter	Total
				(in thousands)			
Operating and capital commitments:							
Debt principal and other (1)	$ 128	$ 1,250	$ 340	$ 373	$ 899,760	$ 951,089	$1,852,940
Debt interest (1)	107,026	107,026	107,026	107,026	85,656	64,287	578,047
Capital leases	1,298	510	22	—	—	—	1,830
Operating leases (2)	61,222	64,390	55,678	51,990	43,184	186,737	463,201
Total operating and capital commitments	169,674	173,176	163,066	159,389	1,028,600	1,202,113	2,896,018
Restructuring-related commitments:							
Operating leases, net of estimated sublease income	3,057	1,903	1,843	1,497	1,374	1,305	10,979
Other	1,910	—	—	—	—	—	1,910
Total restructuring-related commitments	4,967	1,903	1,843	1,497	1,374	1,305	12,889
Total commitments	$174,641	$175,079	$164,909	$160,886	$1,029,974	$1,203,418	$2,908,907

(1) The principal payment due in 2010 and the annual interest payments due under our 6.875% PEACS fluctuate based on the Euro/U.S. Dollar exchange ratio, which at December 31, 2004 was 1.3552. As of December 31, 2004, our principal debt obligation for the 6.875% PEACS has increased by $255 million since its issuance in February 2000 due to fluctuations in the Euro/U.S. Dollar exchange ratio. See "Note 15—Subsequent Events (Unaudited)."

(2) Pursuant to SFAS No. 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 No. 13 they are not reflected on the balance sheet. As of December 31, 2004, we have remaining obligations under operating leases for equipment and real estate of $463 million. If we had applied to our operating leases the same convention used for capital leases, which, however, would not be in accordance with GAAP, we would have recorded approximately $335 million of additional assets and obligations on our balance sheet at December 31, 2004.

See "Note 8—Other Operating Expense (Income)" for additional information about our restructuring-related lease obligations.

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Pledged Securities

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 and for real estate lease agreements. The amount required to be pledged for real estate lease agreements changes over the life of our leases; with fluctuations in our market capitalization, which is common shares outstanding multiplied by the closing price of our common stock; and based on our credit-rating. The change in the total amount of collateral required to be pledged under these agreements is as follows:

	Standby Letters of Credit (1)	Line of Credit (2)	Real Estate Leases (3)	Total
	(in thousands)			
Balance at December 31, 2003	$ 60,799	$ —	$ 25,936	$ 86,735
Net change in collateral pledged	(10,383)	1,933	(4,412)	(12,862)
Balance at December 31, 2004 (4)	$ 50,416	$ 1,933	$ 21,524	$ 73,873

(1) Pursuant to available standby letter-of-credit facilities totaling $151 million.
(2) Pursuant to an available line of credit totaling $10 million.
(3) The required amount of collateral to be pledged on certain of our real estate leases fluctuates based on our market capitalization. At December 31, 2004, our market capitalization was $18.1 billion. If our market capitalization decreases, the required amount of collateral to be pledged will increase $5 million (if market capitalization is less than $18 billion but more than $13 billion) or $11 million (if our market capitalization is less than $13 billion).
(4) Includes $10 million of cash equivalents pledged as collateral. See "Note 2—Cash, Cash Equivalents, and Marketable Securities."

Legal Proceedings

A number of purported class action complaints were filed by holders of our equity and debt securities against us, our directors, and certain of our senior officers during 2001, in the United States District Court for the Western District of Washington, alleging violations of the 1933 Act and/or the 1934 Act (the "Securities Class Actions"). On August 1, 2003, plaintiffs in the 1934 Act cases filed a second consolidated amended complaint alleging that we, together with certain of our officers and directors, made false or misleading statements during the period from October 29, 1998 through October 23, 2001 concerning our business, financial condition and results, inventories, future prospects, and strategic alliance transactions. The 1933 Act complaint alleges that the defendants made false or misleading statements in connection with our February 2000 offering of the 6.875% PEACS. The complaints seek damages and injunctive relief against all defendants. We dispute the allegations of wrongdoing in these complaints and have been vigorously defending ourselves in these matters. See "Note 15—Subsequent Events (Unaudited)."

On October 29, 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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

damages or statutory damages where applicable, attorneys' fees, costs, and disbursements, disgorgement of all sums obtained by allegedly wrongful acts, interest, and declaratory relief. We dispute the allegations of wrongdoing in this complaint, and intend to vigorously defend ourselves in this matter.

Beginning in March 2003, we were served with complaints filed in several different states, including Illinois and Nevada, 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.

On July 17, 2003, Pinpoint, Inc. filed a complaint for patent infringement in the United States District Court for the Northern District of Illinois against us and several other companies with which we have commercial agreements. The complaint was dismissed without prejudice in December 2004. The complaint alleges that our personalization technology infringes patents obtained by Pinpoint and seeks injunctive relief, monetary damages in an amount no less than a reasonable royalty, treble damages for alleged willful infringement, prejudgment interest, and attorneys' fees against all defendants. We dispute the allegations of wrongdoing in this complaint and intend to vigorously defend ourselves in this matter. See "Note 15—Subsequent Events (Unaudited)."

On January 12, 2004, Soverain Software LLC filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges that our website technology infringes several patents obtained by Soverain purporting to cover "Internet Server Access Control and Monitoring Systems" (U.S. Patent No. 5,708,780) and "Network Sales Systems" (U.S. Patent Nos. 5,715,314 and 5,909,492) and seeks injunctive relief, monetary damages in an amount no less than a reasonable royalty, treble damages for alleged willful infringement, prejudgment interest, and attorneys' fees. On October 6, 2004, Soverain filed an amended complaint alleging that we infringe two additional patents purporting to cover "Digital Active Advertising" (U.S. Patent No. 6,195,649) and an "Open Network Payment System for Providing Real-Time Authorization of Payment and Purchase Transactions" (U.S. Patent No. 6,205,437). The patents asserted in the amended complaint have since been severed from those asserted in the original complaint, and accordingly a separate complaint has been filed for those patents. We dispute the allegations of wrongdoing in these complaints and intend to vigorously defend ourselves in this matter.

On January 22, 2004, IPXL Holdings, LLC brought an action against us for patent infringement in the United States District Court for the Eastern District of Virginia. The complaint alleges that aspects of our online ordering technology, including 1-Click® ordering, infringe a patent obtained by IPXL purporting to cover an "Electronic Fund Transfer or Transaction System" (U.S. Patent No. 6,149,055) and seeks injunctive relief, monetary damages in an amount no less than a reasonable royalty, prejudgment interest, and attorneys' fees. On August 25, 2004, the Court entered a judgment in Amazon.com's favor on the grounds that the patent claims asserted by the plaintiff were invalid and that Amazon.com's technology did not infringe those claims in any event. The Court also awarded Amazon.com its attorneys' fees and costs. Plaintiff is appealing that judgment.

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

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On May 21, 2004, Toysrus.com LLC filed a complaint against us for breach of contract in the Superior Court of New Jersey. The complaint alleges 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 alleges it has an exclusive right to sell on our website. The complaint seeks injunctive relief, declaratory judgment and either monetary damages of an unspecified amount or rescission of the commercial agreement and return of specific amounts paid under the agreement totaling $200 million. We dispute the allegations of wrongdoing in this complaint and have brought counterclaims alleging breach of contract and seeking damages and declaratory relief. We intend to vigorously defend ourselves in this matter.

On September 14, 2004, BTG International Inc. 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 Associates program, infringes two patents obtained by BTG purporting to cover methods and apparatuses for "Attaching Navigational History Information to Universal Resource Locator Links on a World Wide Web Page" (U.S. Patent No. 5,712,979) and for "Tracking the Navigation Path of a User on the World Wide Web" (U.S. Patent No. 5,717,860) 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. We dispute the allegations of wrongdoing in this complaint and intend to vigorously defend ourselves in this matter.

On October 29, 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 alleges 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 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. See "Note 15—Subsequent Events (Unaudited)."

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.

Inventory Suppliers

During 2004, no vendor accounted for 10% or more of our inventory purchases. 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.

Note 6—STOCKHOLDERS' DEFICIT

Preferred Stock

We have authorized 500 million shares of $0.01 par value Preferred Stock. No preferred stock shares were outstanding during 2004, 2003, or 2002.

Stock Award Plans

Employees vest in restricted stock unit awards and stock options ratably over the corresponding service term, generally three to six years. Outstanding stock options generally have a term of 10 years from the date of grant.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Stock Award Activity

We granted stock awards, which since October 2002 have consisted primarily of restricted stock units, representing 3 million, 2 million, and 6 million shares of common stock during 2004, 2003, and 2002 with a per share weighted average fair value of $43.77, $30.14, and $17.55.

Common shares outstanding (which includes restricted stock), plus shares underlying outstanding stock options and restricted stock units totaled 434 million, 433 million, and 433 million at December 31, 2004, 2003 and 2002. Common shares outstanding increased by 6 million shares and 15 million shares during 2004 and 2003, due to exercises of stock options, vesting of restricted stock units, and matching contributions under our 401(k) savings plan.

The following summarizes our restricted stock unit activity (in thousands):

Outstanding at December 31, 2001	—
Units granted	2,964
Units vested	—
Units cancelled	(10)
Outstanding at December 31, 2002	2,954
Units granted	2,109
Units vested	(380)
Units cancelled	(273)
Outstanding at December 31, 2003	4,410
Units granted	3,277
Units vested	(741)
Units cancelled	(520)
Outstanding at December 31, 2004	6,426

Scheduled vesting for outstanding restricted stock units at December 31, 2004 is as follows (in thousands):

	2005	2006	2007	2008	2009	Thereafter	Total
Scheduled annual vesting—restricted stock units	1,118	1,925	1,779	1,032	389	183	6,426

The following table summarizes our stock option activity:

	Number of Shares (In thousands)	Weighted Average Exercise Price
Balance December 31, 2001	65,950	$ 10.65
Options granted	3,045	16.46
Options terminated	(12,262)	10.36
Options exercised	(14,728)	8.26
Balance December 31, 2002	42,005	11.91
Options granted	226	24.81
Options terminated	(2,248)	13.82
Options exercised	(15,022)	10.88
Balance December 31, 2003	24,961	12.46
Options granted	187	33.80
Options terminated	(1,258)	15.66
Options exercised	(5,549)	10.78
Balance December 31, 2004	18,341	12.98

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Additionally, we granted 0.33 million shares and terminated 0.35 million shares of restricted stock in 2002. No shares of restricted stock were granted or terminated in 2004 or 2003. As matching contributions under our 401(k) savings plan, we granted 0.07 million and 0.03 million shares of common stock in 2004 and 2003. No matching contributions were made in 2002. Shares granted as matching contributions under our 401(k) plan and shares of restricted stock are included in outstanding common stock when issued.

The following table summarizes information about stock options outstanding at December 31, 2004:

	Stock Awards Outstanding			Awards Vested	
Range of Exercise Prices	Number of Awards (In thousands)	Remaining Life (yrs)	Weighted Average Exercise Price	Number of Awards (In thousands)	Weighted Average Exercise Price
0.08 – 10.49	13,785	6.1	$ 7.61	4,525	$ 6.89
10.50 – 20.99	2,683	6.3	16.43	1,337	16.68
21.00 – 31.49	682	5.3	25.47	475	25.03
31.50 – 41.99	200	5.8	37.58	146	37.60
42.00 – 52.48	222	6.7	44.18	120	44.74
52.49 – 62.98	93	4.2	55.65	92	55.66
62.99 – 73.48	563	4.2	70.84	262	70:34
73.49 – 83.98	49	4.1	75.59	49	75.59
83.99 – 94.47	63	4.2	87.83	63	87.86
94.48 – 104.97	1	4.3	104.97	1	104.97
0.08 – 104.97	18,341	6.0	12.98	7,070	15.43

Common Stock Available for Future Issuance

At December 31, 2004, common stock available for future issuance is as follows (in thousands):

Stock awards	113,600
Shares issuable upon conversion of 4.75% Convertible Subordinated Notes	11,531
Shares issuable upon conversion of 6.875% PEACS	8,129
Total common stock reserved for future issuance	133,260

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 7—OTHER COMPREHENSIVE INCOME

The changes in the components of other comprehensive income (loss) were as follows (in thousands):

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Net income (loss)	$588,451	$ 35,282	$(149,132)
Foreign currency translation gains	(502)	14,707	16,910
Net unrealized gains (losses) on available-for-sale securities:			
Unrealized gains (losses) arising during the year	5,472	17,434	23,459
Less reclassification of net realized (gains) losses included in net income (loss)	(11,161)	(14,952)	(3,165)
Net unrealized gains (losses) on available-for-sale securities:	(5,689)	2,482	20,294
Net activity of terminated Euro Currency Swap:			
Remeasurement of Euro Currency Swap to fair value	—	14,842	21,106
Reclassification of (gains) losses to offset currency losses and gains on hedged portion of 6.875% PEACS included in net income (loss)	—	(5,081)	(12,578)
Amortization of net unrealized losses on terminated euro Currency Swap	1,786	1,127	—
Net activity of terminated Euro Currency Swap	1,786	10,888	8,528
Tax effect of other comprehensive income, net	(1,225)	—	—
Other comprehensive income (loss)	(5,630)	28,077	45,732
Comprehensive income (loss)	$582,821	$ 63,359	$(103,400)

Tax effect in 2004 of other comprehensive income relates to the following components (in thousands):

Net unrealized gains (losses) on available-for-sale securities	
Unrealized gains arising during the year	$ 5,097
Reclassification of net realized gains included in net income	(10,394)
	(5,297)
Amortization of net unrealized losses on terminated Euro Currency Swap	4,072
Net tax effect on other comprehensive income	$ (1,225)

Accumulated balances within other comprehensive income were as follows (in thousands):

	December 31,	
	2004	2003
	(in thousands)	
Net unrealized gains on foreign currency translation	$29,948	$ 30,450
Net unrealized gains on available-for-sale securities, net of tax	9,341	20,327
Net unrealized losses on terminated Euro Currency Swap, net of tax	(7,180)	(13,038)
Total accumulated other comprehensive income	$32,109	$ 37,739

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 8—OTHER OPERATING EXPENSE (INCOME)

Other operating expense (income) was $(8) million, $3 million, and $47 million for 2004, 2003, and 2002, which includes restructuring-related expenses (credits) and amortization of other intangibles. Restructuring-related expenses (credits) were $(9) million, $0 million, and $42 million; and amortization of other intangibles was $1 million, $3 million, and $5 million for 2004, 2003, and 2002.

During 2004, we determined that certain of the office space previously vacated as part of our 2001 restructuring, which we had been unable to sublease due to poor real estate market conditions, was necessary for our future needs. We reduced our restructuring-related liability resulting in a gain of $13 million for 2004. Lease payments for this office space are expensed over the lease period and classified to the corresponding operating expense categories on the consolidated statements of operations.

In 2004, we streamlined our organizational structure in France to reduce our operating costs. These efforts were primarily focused on eliminating French-office positions in managerial, professional, clerical, and technical roles. The number of employees affected totaled 52 and resulted in severance costs of $4 million classified in "Other operating expense (income)" on the consolidated statements of operations.

Restructuring-related charges were as follows (in thousands):

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Asset impairments	$ —	$—	$ 1,182
Continuing lease obligations	(12,304)	140	39,563
Termination benefits	4,225	—	—
Broker commissions, professional fees, and other miscellaneous restructuring costs	(968)	—	828
Total restructuring-related charges	$ (9,047)	$140	$41,573

At December 31, 2004, the accrued liability associated with restructuring-related and other charges was $13 million and consisted of the following:

	Balance at December 31, 2003	Subsequent Accruals (Credits), net	Payments	Balance at December 31, 2004	Due Within 12 Months (1)	Due After 12 Months (1)
			(in thousands)			
Lease obligations, net of estimated sublease income	$ 29,343	$ (12,304)	$(6,060)	$ 10,979	$ 3,057	$ 7,922
Termination benefits	—	4,225	(2,464)	1,761	1,761	—
Broker commissions, professional fees and other miscellaneous restructuring costs	1,197	(968)	(80)	149	149	—
Total restructuring-related liability	$ 30,540	$ (9,047)	$(8,604)	$ 12,889	$ 4,967	$ 7,922

(1) Restructuring-related liabilities due within 12 months are classified in "Accrued expenses and other current liabilities" and liabilities due after 12 months are classified in "Long-term debt and other" on our consolidated balance sheets.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Restructuring-related lease obligations are as follows:

	2005	2006	2007	2008	2009	Thereafter	Total
				(in thousands)			
Gross lease obligations	$ 6,139	$ 5,389	$ 5,363	$ 4,516	$ 4,418	$ 5,418	$ 31,243
Estimated sublease income (1)	(3,082)	(3,486)	(3,520)	(3,019)	(3,044)	(4,113)	(20,264)
Estimated net lease obligations	$ 3,057	$ 1,903	$ 1,843	$ 1,497	$ 1,374	$ 1,305	$ 10,979

(1) At December 31, 2004, we had signed contractual sublease agreements covering $13 million in future payments.

Note 9—OTHER INCOME (EXPENSE), NET

Other income (expense), net consisted of the following:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Gains on sales of marketable securities, net	$ 586	$ 9,598	$ 5,700
Foreign-currency transaction losses, net	(5,214)	(3,043)	(1,086)
Other miscellaneous gains (losses), net	(73)	(41)	309
Total other income (expense), net	$(4,701)	$ 6,514	$ 4,923

Foreign-currency transaction losses primarily relate to the interest payable on our 6.875% PEACS. Since these payments are settled in Euros, the balance of interest payable (which is paid annually in February) is subject to gains or losses resulting from changes in exchange rates between the U.S. Dollar and Euro between reporting dates and payment.

Note 10—REMEASUREMENTS AND OTHER

Remeasurements and other consisted of the following:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Foreign-currency losses on remeasurement of 6.875% PEACS (1)	$(65,375)	$(140,130)	$(103,136)
Gain on sales of Euro-denominated investments, net	9,469	5,827	2,227
Gain on sales of equity investments, net	15,406	796	13,044
Loss on redemption of long-term debt	(5,672)	(23,829)	—
Loss on termination of Euro Currency Swap (2)	—	(5,880)	—
Foreign-currency effect on intercompany balances (3)	40,883	35,574	—
Other-than-temporary impairments and other (4)	4,465	(2,455)	(12,577)
Total remeasurements and other	$ (824)	$(130,097)	$(100,442)

(1) Each period the remeasurement of our 6.875% PEACS from Euros to U.S. Dollars results in gains or losses recorded to "Remeasurements and other" on our consolidated statements of operations.
(2) Represents the remaining basis in our swap asset upon date of termination.
(3) Represents the gains associated with the remeasurement of intercompany balances due to changes in foreign exchange rates. See "Note 1—Description of Business and Accounting Policies."
(4) Included in 2004 is a gain of $6 million relating to the settlement of a contractual dispute, and included in 2003 and 2002 is $0.4 million and $4 million of losses from equity-method investees. No equity-method losses or income were reported in 2004.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 11—INCOME TAXES

Cash taxes paid were $4 million, $2 million, and $1 million for 2004, 2003, and 2002.

The components of the provision for income taxes, net are as follows:

	December 31,		
	2004	2003	2002
Current taxes:			
U.S. and state	$ 12,148	$ 362	$ 5
International	11,967	2,413	(152)
Current taxes	24,115	2,775	(147)
Deferred taxes	(256,696)	931	(553)
Provision for income taxes, net	$(232,581)	$3,706	$(700)

U.S. and international components of income (loss) before income taxes are as follows:

	December 31,		
	2004	2003	2002
U.S.	$359,268	$ 58,208	$(167,720)
International	(3,398)	(19,220)	17,888
Income (loss) before income taxes	$355,870	$ 38,988	$(149,832)

Total income tax expense/(benefit) and amounts allocated to stockholders' deficit were as follows:

	2004	2003	2002
Income from continuing operations	$(232,581)	$ 3,706	$(700)
Stockholders' deficit	(105,883)	(2,224)	23
	$(338,464)	$ 1,482	$(677)

The items accounting for differences between income taxes computed at the federal statutory rate and the provision (benefit) recorded for income taxes are as follows:

	December 31,		
	2004	2003	2002
Federal statutory rate	35.0%	35.0%	35.0%
Effect of:			
Decrease in beginning-of-year balance of the valuation allowance	(102.2)%	(57.1)%	(37.4)%
Net operating losses of foreign subsidiaries not benefited	2.5%	25.7%	(0.4)%
Permanent differences, state income taxes, and other	(0.7)%	5.9%	3.3%
Total	(65.4)%	9.5%	0.5%

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The significant components of deferred income tax expense/(benefit) attributable to income from continuing operations for the year ended December 31, 2004 are as follows:

	For the year ended December 31,		
	2004	2003	2002
Deferred tax expense/(benefit) exclusive of the effect of the items listed below	$ 145,374	$ 43,093	$ 1,468
Decrease in beginning-of-year balance of the valuation allowance	(240,067)	—	—
Tax benefit of net operating loss carryforwards	(162,003)	(42,162)	(2,021)
Total deferred tax expense/(benefit)	$(256,696)	$ 931	$ (553)

Deferred income taxes were:

	December 31,	
	2004	2003
Deferred tax assets:		
Net operating losses	$ 801,000	$ 898,000
Assets held for investment	273,000	343,000
Revenue items	29,000	25,000
Expense items, including stock-based compensation	128,000	235,000
Tax credits	6,000	—
Total gross deferred tax assets	1,237,000	1,501,000
Less valuation allowance	(874,000)	(1,496,000)
Net deferred tax assets	363,000	5,000
Deferred tax liabilities:		
Expense items	(7,000)	(3,000)
Net deferred tax	$ 356,000	$ 2,000

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when taxes are actually paid or recovered.

We periodically evaluate the likelihood of the realization of deferred tax assets, and reduce the carrying amount of these deferred tax assets 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 carryforward 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.

We had a net tax benefit in 2004 of $233 million, representing $0.57 and $0.55 of basic and diluted earnings per share, resulting primarily from the effect of changes in our valuation assessment of deferred tax assets during 2004. In connection with this assessment we also recorded a net credit to "Stockholders' Deficit" of $106 million on our consolidated balance sheet for 2004.

At December 31, 2004, our gross deferred tax assets related to our NOLs were approximately $800 million (relating to approximately $2.6 billion of NOLs), offset by a valuation allowance of approximately $530 million

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

due to uncertainty about their future realization. If in the future we determine that the remaining $530 million of NOL deferred tax assets is more likely than not to be realizable, substantially all would be credited to "Stockholders' Deficit" rather than the income statement since they primarily relate to tax-deductible stock-based compensation in excess of amounts recognized for financial reporting purposes. The majority of our NOLs expire after 2016. In addition, utilization of NOLs may be subject to certain limitations under Sections 382 and 1502 of the Internal Revenue Code of 1986, as amended, and other limitations under state and foreign tax laws.

We also have approximately $70 million of deferred tax assets relating to approximately $225 million capital loss carryforwards that expire in 2005 and thereafter. Due to uncertainty regarding future realization, we have provided a full valuation allowance for this portion of our deferred tax asset.

We have not provided for U.S. deferred income taxes or foreign withholding taxes on non-U.S. subsidiaries' undistributed earnings totaling $20 million as of December 31, 2004 because these earnings are intended to be permanently reinvested in operations outside of the United States.

Note 12—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 operating decision maker reviews our operating results in assessing performance and allocating resources.

Direct segment operating expenses include the operating expenses "Fulfillment," "Marketing," "Technology and content," and "General and administrative," but not "Stock-based compensation" or "Other operating income (expense)." 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.

North America

The North America segment consists of amounts earned from retail sales of consumer products (including from third-party sellers) through *www.amazon.com* and *www.amazon.ca*, from North America focused Syndicated Stores and mail-order catalogs, and from non-retail activities such as North America focused Merchant.com, marketing, and promotional agreements.

International

The International segment consists of amounts earned from retail sales of consumer products (including from third-party sellers) through internationally-focused websites, such as *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr*, *www.amazon.co.jp*, and *www.joyo.com*, from internationally-focused Syndicated Stores and from non-retail activities such as internationally-focused marketing and promotional agreements. This segment includes export sales from *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr*, *www.amazon.co.jp*, and *www.joyo.com* (including export sales from these sites to customers in the U.S. and Canada), but excludes export sales from *www.amazon.com* and *www.amazon.ca*.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Information on reportable segments and reconciliation to consolidated net income (loss) is as follows (in thousands):

Year Ended December 31, 2004:

	North America	International	Consolidated
Net sales	$ 3,847,344	$ 3,073,780	$ 6,921,124
Cost of sales	2,823,792	2,495,335	5,319,127
Gross profit	1,023,552	578,445	1,601,997
Direct segment operating expenses	702,676	409,158	1,111,834
Segment operating income	320,876	169,287	490,163
Stock-based compensation			57,702
Other operating income			(7,964)
Income from operations			440,425
Total non-operating expense, net			84,555
Benefit from income taxes, net			(232,581)
Net income			$ 588,451

Year Ended December 31, 2003:

	North America	International	Consolidated
Net sales	$ 3,258,413	$ 2,005,286	$ 5,263,699
Cost of sales	2,391,749	1,614,782	4,006,531
Gross profit	866,664	390,504	1,257,168
Direct segment operating expenses	583,619	312,311	895,930
Segment operating income	283,045	78,193	361,238
Stock-based compensation			87,751
Other operating expenses			2,892
Income from operations			270,595
Total non-operating expense, net			231,607
Provision for income taxes, net			3,706
Net income			$ 35,282

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Year Ended December 31, 2002:

	North America	International	Consolidated
Net sales	$ 2,761,457	$ 1,171,479	$ 3,932,936
Cost of sales	2,020,472	919,846	2,940,318
Gross profit	740,985	251,633	992,618
Direct segment operating expenses	561,318	251,198	812,516
Segment operating income	179,667	435	180,102
Stock-based compensation			68,927
Other operating income			47,051
Income from operations			64,124
Total non-operating expense, net			214,757
Provision for income taxes, net			(700)
Cumulative effect of change in accounting principle			(801)
Net loss			$ (149,132)

Net sales shipped to customers outside of the U.S. represented approximately 49%, 43%, and 35% of net sales for 2004, 2003, and 2002. Net sales from *www.amazon.co.uk*, *www.amazon.de*, and *www.amazon.co.jp* each represented 10% or more of consolidated net sales in 2004, and net sales from *www.amazon.co.uk* and *www.amazon.de* each represented 10% or more of consolidated net sales in 2003 and 2002. Net fixed assets held in locations outside the U.S. were $57 million, $45 million, and $44 million at December 31, 2004, 2003, and 2002.

Total assets, by segment, reconciled to consolidated amounts were (in thousands):

	December 31,		
	2004	2003	2002
North America	$ 1,921,686	$ 1,276,300	$ 1,525,038
International	1,326,822	885,733	465,411
Consolidated	$ 3,248,508	$ 2,162,033	$ 1,990,449

Depreciation expense, by segment, was as follows (in thousands):

	North America	International	Consolidated
2004	$63,173	$ 11,490	$ 74,663
2003	59,558	10,186	69,744
2002	67,036	9,625	76,661

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 13—FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amount and estimated fair values of our financial instruments were as follows (in thousands):

	December 31,			
	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 1,302,600	$ 1,302,600	$ 1,102,273	$ 1,102,273
Marketable securities (1)	476,599	476,599	292,550	292,550
Other equity investments (2)	15,018	59,092	14,831	86,517
Long-term debt (3)	1,834,846	1,842,763	1,919,471	1,924,995

(1) The fair value of marketable securities is determined from publicly quoted prices. See "Note 2—Cash, Cash Equivalents, and Marketable Securities."
(2) The fair value of other equity investments is determined from publicly quoted prices, plus the carrying amount of privately-held investments for which market values are not readily determinable. We evaluate "Other equity investments" for impairment in accordance with our stated policy. See "Note 1—Description of Business and Accounting Policies."
(3) The fair value of our long-term debt is determined based on quoted prices. See "Note 4—Long-Term Debt and Other."

Note 14—QUARTERLY RESULTS (UNAUDITED)

The following tables contain selected unaudited statement of operations information for each quarter of 2004, 2003, and 2002. The following information reflects all normal recurring adjustments necessary for a fair presentation of the information for the periods presented. The operating results for any quarter are not necessarily indicative of results for any future period. Unaudited quarterly results were as follows (in thousands, except per share data):

	Year Ended December 31, 2004			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$ 2,540,959	$ 1,462,475	$ 1,387,341	$ 1,530,349
Gross profit	544,466	355,651	341,046	360,834
Net income	346,688	54,147	76,480	111,136
Basic earnings per share (1)	$ 0.85	$ 0.13	$ 0.19	$ 0.28
Diluted earnings per share (1)	$ 0.82	$ 0.13	$ 0.18	$ 0.26
Shares used in computation of earnings (loss) per share:				
Basic	408,227	406,647	405,268	403,542
Diluted	425,034	424,777	424,678	424,519

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AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Year Ended December 31, 2003			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$ 1,945,772	$ 1,134,456	$ 1,099,912	$ 1,083,559
Gross profit	426,837	285,821	273,928	270,582
Net income (loss)	73,154	15,563	(43,314)	(10,121)
Basic earnings (loss) per share (1)	$ 0.18	$ 0.04	$ (0.11)	$ (0.03)
Diluted earnings (loss) per share (1)	$ 0.17	$ 0.04	$ (0.11)	$ (0.03)
Shares used in computation of earnings (loss) per share:				
Basic	401,422	397,912	393,876	388,541
Diluted	425,214	422,802	393,876	388,541

	Year Ended December 31, 2002			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$1,428,610	$851,299	$805,605	$847,422
Gross profit	335,159	216,167	218,167	223,125
Income (loss) before change in accounting principle	2,651	(35,080)	(93,553)	(23,951)
Cumulative effect of change in accounting principle	—	—	—	$ 801
Net income (loss)	2,651	$(35,080)	$(93,553)	$(23,150)
Basic and diluted earnings (loss) per share (1):				
Prior to cumulative effect of change in accounting principle	$ 0.01	$ (0.09)	$ (0.25)	$ (0.06)
Cumulative effect of change in accounting principle	—	—	—	—
	$ 0.01	$ (0.09)	$ (0.25)	$ (0.06)
Shares used in computation of earnings (loss) per share:				
Basic	383,702	379,650	376,937	373,031
Diluted	407,056	379,650	376,937	373,031

(1) The sum of quarterly per share amounts may not equal per share amounts reported for year-to-date periods. This is due to changes in the number of weighted-average shares outstanding and the effects of rounding for each period.

Note 15—SUBSEQUENT EVENTS (UNAUDITED)

On March 7, 2005, we redeemed 200 million Euros principal of our 6.875% PEACS for a cash payment of $266 million, which includes $1 million of interest from and including February 16 through March 6, 2005. Under the Indenture, no premium was required. As of March 7, 2005, the outstanding principal amount of our 6.875% PEACS was 490 million Euros ($649 million using the Euro to U.S. Dollar exchange rate on that date).

Regarding litigation matters, in March 2005, we signed a Stipulation of Settlement with counsel representing the alleged plaintiff class, with respect to the 1934 Act claims in the Securities Class Actions. If approved by the court, the settlement would dispose of all claims arising under the 1934 Act, but not the 1933 Act, in exchange for a payment of $27,500,000, most if not all of which we expect to be funded by our insurers. In the Pinpoint litigation, the lawsuit was refiled in March 2005 in the U.S. District Court for the Northern District of Illinois after being dismissed without prejudice by the same court in December 2004. In the Cendant litigation, Cendant voluntarily withdrew its complaint without prejudice in February 2005. However, we expect the plaintiff to refile the claims unless they are otherwise settled or disposed of. See "Note 5—Commitments and Contingencies—Legal Proceedings."

Item 9. ***Changes in and Disagreements with Accountants On Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by 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 December 31, 2004. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of December 31, 2004, our disclosure controls and procedures were effective in timely alerting them to material information required to be included in our periodic SEC reports.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) of the 1934 Act. Management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2004 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. As a result of this assessment, management concluded that, as of December 31, 2004, our internal control over financial reporting was effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Ernst & Young LLP has issued an attestation report on management's assessment of internal control over financial reporting, a copy of which is included in this annual report on Form 10-K.

Limitations on Controls

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting 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.

Report of Ernst & Young LLP
Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Amazon.com, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Amazon.com, Inc. maintained effective internal control over financial reporting, as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Amazon.com, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Amazon.com, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Amazon.com, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Amazon.com, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' deficit, and cash flows for each of the three years in the period ended December 31, 2004 of Amazon.com, Inc. and our report dated February 24, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Seattle, Washington
February 24, 2005

Item 9B. ***Other Information***

None.

PART III

Item 10. ***Directors and Executive Officers of the Registrant***

Information regarding our Executive Officers required by Item 10 of Part III is set forth in Item 1 of Part I "Business—Executive Officers and Directors." Information required by Item 10 of Part III regarding our Directors is included in our Proxy Statement relating to our 2005 Annual Meeting of Shareholders, and is incorporated herein by reference. Information relating to our Code of Business Conduct and Ethics and to compliance with Section 16 (a) of the 1934 Act is set forth in our Proxy Statement relating to our 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

Item 11. ***Executive Compensation***

Information required by Item 11 of Part III is included in our Proxy Statement relating to our 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information required by Item 12 of Part III is included in our Proxy Statement relating to our 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

Item 13. ***Certain Relationships and Related Transactions***

Information required by Item 13 of Part III is included in our Proxy Statement relating to our 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

Item 14. ***Principal Accountant Fees and Services***

Information required by Item 14 of Part III is included in our Proxy Statement relating our 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

Item 15. ***Exhibits, Financial Statement Schedules***

(a) *List of Documents Filed as a Part of This Report:*

(1) *Index to Consolidated Financial Statements:*

Report of Ernst & Young LLP, Independent Auditors

Consolidated Statements of Cash Flows for each of the three years ended December 31, 2004

Consolidated Statements of Operations for each of the three years ended December 31, 2004

Consolidated Balance Sheets as of December 31, 2004 and 2003

Consolidated Statements of Stockholders' Deficit for each of the three years ended December 31, 2004

Notes to Consolidated Financial Statements

(2) *Index to Financial Statement Schedules:*

Schedule II—Valuation and Qualifying Accounts

All other schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto, or is not applicable or required.

(3) *Index to 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 Quarter 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 Quarter Ended March 31, 2002).
4.1	Indenture, dated as of February 3, 1999, between Amazon.com, Inc. and The Bank of New York, as trustee, including the form of 4 ¾% Convertible Subordinated Notes Due 2009 attached as Exhibit A thereto (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.2	Registration Rights Agreement, dated February 3, 1999, by and among Amazon.com, Inc. and the Initial Purchasers (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.3	Indenture, dated as of February 16, 2000, between Amazon.com, Inc. and the Bank of New York, as trustee (incorporated by reference to the Company's Current Report on Form 8-K dated February 16, 2000).
4.4	Form of 6 7/8% Convertible Subordinated Notes due 2010 (incorporated by reference to the Company's Current Report on Form 8-K dated February 28, 2000).
10.1†	Amended and Restated 1994 Stock Option Plan (version as of December 20, 1996 for Amended and Restated Grants and version as of December 20, 1996 for New Grants) (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.2†	1997 Stock Incentive Plan (incorporated by reference to Appendix B to the Company's Proxy Statement on Schedule 14A, filed with the Securities and Exchange Commission on March 29, 2000).
10.3†	1999 Non-Officer Employee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 333-74419) filed March 15, 1999).
10.4†	Form of Indemnification Agreement between the Company and each of its Directors (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.5†	Offer Letter of Employment to Rick Dalzell, dated August 13, 1997 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 1999).
10.6†	Offer Letter of Employment to Diego Piacentini, dated January 17, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.7†	Offer Letter of Employment to Thomas J. Szkutak, dated August 26, 2002 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.8†	Offer Letter of Employment to Kal Raman, dated July 29, 2004.

Exhibit Number	Description
10.9†	Form of Restricted Stock Unit Agreement for Officers and Employees (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.10†	Form of Restricted Stock Unit Agreement for Directors (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.11†	Form of Restricted Stock Agreement (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2001).
12.1	Computation of Ratio of Earnings to Fixed Charges.
18.1	Preferability Letter of Ernst & Young LLP, Independent Auditors, regarding change in accounting principle (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2002).
21.1	List of Significant Subsidiaries.
23.1	Consent of Ernst & Young LLP, Independent Auditors.
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.

† Executive Compensation Plan or Agreement

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, as of March 9, 2005.

AMAZON.COM, INC.

By: /s/ JEFFREY P. BEZOS

Jeffrey P. Bezos
President, Chief Executive Officer
and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities indicated as of March 9, 2005.

Signature	Title
/s/ JEFFREY P. BEZOS Jeffrey P. Bezos	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
/s/ THOMAS J. SZKUTAK Thomas J. Szkutak	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ MARK S. PEEK Mark S. Peek	Vice President and Chief Accounting Officer (Principal Accounting Officer)
/s/ TOM A. ALBERG Tom A. Alberg	Director
/s/ JOHN SEELY BROWN John Seely Brown	Director
/s/ L. JOHN DOERR L. John Doerr	Director
/s/ WILLIAM B. GORDON William B. Gordon	Director
/s/ MYRTLE S. POTTER Myrtle S. Potter	Director
/s/ THOMAS O. RYDER Thomas O. Ryder	Director
/s/ PATRICIA Q. STONESIFER Patricia Q. Stonesifer	Director

AMAZON.COM, INC.
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Accounts receivable and other current assets—Reserves

	Balance at Beginning of Period	Charged to Costs and Expenses	Amounts Written Off	Balance at End of Period
		(in thousands)		
December 31, 2004	$17,594	$ 29,642	$ (24,450)	$22,786
December 31, 2003	19,967	17,788	(20,161)	17,594
December 31, 2002	13,235	7,368	(636)	19,967

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EXHIBIT INDEX

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† Executive Compensation Plan or Agreement

Exhibit 10.8

July 29, 2004

Dear Kal:

On behalf of Amazon Global Resources, Inc. (the "Company"), I am very pleased to offer you the position of Senior Vice President, reporting to Jeff Bezos. This letter clarifies and confirms the terms of your employment with the Company.

Start Date and Salary

Your start date will be mutually determined by you and Amazon Global Resources. Your starting salary will be $125,000 annualized, payable in accordance with the Company's standard payroll practice and subject to applicable withholding taxes. Because your position is exempt from overtime pay, your salary will compensate you for all hours worked.

Signing Bonus

In appreciation for your decision to join us, the Company will pay you a signing bonus of $300,000 during your first year of employment, which will be paid in twelve monthly installments, starting at the end of your first month. If you are employed with the Company on the one-year anniversary of your hire date, the company will pay you a second bonus in the amount of $500,000 during your second year of employment, which will be paid in twelve monthly installments. Both bonuses will be payable in accordance with the Company's standard payroll practice and subject to applicable withholding taxes. If your employment with the Company is terminated for any reason prior to your second anniversary of employment, any monthly payments will cease after the date of termination.

Benefits

You will also be entitled, during the term of your employment, to such vacation, medical and other employee benefits as the Company may offer from time to time, subject to applicable eligibility requirements. The Company does reserve the right to make any modifications in this benefits package that it deems appropriate. Please refer to the enclosed benefits documents for more information. You are eligible to participate in Amazon.com's 401(k) plan following receipt of a PIN number and Information Packet from the plan administrator (currently Putnam). You are also eligible to enroll in our major medical plan on the first day of the month coincident with or following the commencement of your employment.

Restricted Stock Unit Award

Subject to Board of Directors' approval, you will be granted a restricted stock unit award with respect to 200,000 shares of Amazon.com common stock. This award will vest and convert into shares of common stock at the rate of 10% after two years of employment, an additional 10% after three years, an additional 20% after four years, an additional 30% after five years and the remaining 30% after your sixth year of employment, all subject to your continued employment with Amazon.com. Your award will be documented by delivery to you of a Restricted Stock Unit Award Agreement specifying the terms and conditions of the award.

Customer Connection

You will participate in Amazon.com's Customer Connection ("C2") Program, which keeps our senior employees in direct contact with our customers. Under this program, you will work at our customer service center for three days during your first six months of employment and on a regular basis thereafter. You'll also work at one of our fulfillment centers for five days during your first two years of employment. Please contact your Human Resources Generalist for more information.

Employment At Will

If you accept our offer of employment, you will be an employee-at-will, meaning that either you or the Company may terminate our relationship at any time for any reason, with or without cause. Any statements to the contrary that may have been made to you, or that may be made to you, by the Company, its agents, or representatives are superseded by this offer letter.

Confidentiality, Noncompetition and Invention Assignment Agreement

As a condition of your employment, you must sign the enclosed Confidentiality, Noncompetition and Invention Assignment Agreement (the "Agreement"). The Company's willingness to grant you the restricted stock unit award referred to above is based in significant part on your commitment to fulfill the obligations specified in the Agreement. You should know that the agreement will significantly restrict your future flexibility in many ways. For example, you will be unable to seek or accept certain employment opportunities for a period of 18 months after you leave the Company. Please review the agreement carefully and, if appropriate, have your attorney review it as well.

Employment Eligibility

To comply with immigration laws, you must provide Amazon.com with evidence of your identity and eligibility for employment in the United States no later than three (3) business days of your date of hire. Please bring this documentation to your new hire orientation. If you are in visa status, you also must provide new or renewed evidence of your eligibility for employment immediately prior to or upon expiration of your visa authorization.

Additional Provisions

If you accept this offer, the terms described in this letter will be the terms of your employment, and this letter supersedes any previous discussions or offers. Any additions to or modifications of these terms must be in writing and signed by you and an officer of the Company.

If you wish to accept employment with the Company, please indicate so by signing both copies of this letter and both copies of the enclosed Confidentiality, Noncompetition and Invention Assignment Agreement, retaining one of each for your files. This offer and all terms of employment stated in this letter will expire if you have not returned a signed copy of this letter in the pre-addressed enclosed envelope by the sooner of three weeks from the date of this letter or five days prior to the above Start Date. If you intend to start your employment within five days of receiving this offer, please contact me immediately.

We are very excited about the possibility of you joining us. I hope that you will accept this offer and look forward to a productive and mutually beneficial working relationship. Please let me know if I can answer any questions for you about any of the matters outlined in this letter.

Sincerely,

Jeffrey P. Bezos
Founder and CEO

ACCEPTANCE

I accept employment with Amazon Global Resources, Inc. under the terms set forth in this letter:

/s/ KAL RAMAN
Signature

7/31/04
Date

Kal Raman

Exhibit 12.1

Ratio of Earnings To Fixed Charges

	Year Ended December 31,				
	2004	2003	2002	2001	2000
			(amounts in thousands)		
Income (loss) before income taxes	$ 355,870	$ 38,988	$(150,633)	$(566,733)	$(1,406,169)
Equity in losses of equity-method investees	—	436	4,169	30,327	304,596
Net income (loss) before equity in losses of equity-method investees	355,870	39,424	(146,464)	(536,406)	(1,101,573)
Plus fixed charges:					
Interest expense including amortization of debt issuance costs	107,227	129,979	142,925	139,232	130,921
Assumed interest element included in rent expense	3,881	5,718	6,205	8,880	10,773
	111,108	135,697	149,130	148,112	141,694
Adjusted earnings (loss)	466,978	175,121	2,666	(388,294)	(959,879)
Fixed charges	(111,108)	(135,697)	(149,130)	(148,112)	(141,694)
Excess (deficiency) of earnings to cover fixed charges	$ 355,870	$ 39,424	$(146,464)	$(536,406)	$(1,101,573)
Ratio of earnings to fixed charges (1)	4.20	1.29	0.02	(2.62)	(6.77)

(1) The ratio of earnings to fixed charges is computed by dividing (i) income (loss) before income taxes and losses from equity interests, plus fixed charges by (ii) fixed charges.

Exhibit 21.1

AMAZON.COM, INC.
LIST OF SIGNIFICANT SUBSIDIARIES

Legal Name	Jurisdiction	Percent Owned
Amazon.com Holdings, Inc.	Delaware	100%
Amazon.com LLC	Delaware	100%
Amazon.com.nvdc, Inc.	Delaware	100%
Amazon.com.nddc, Inc.	Delaware	100%
Amazon.com.ksdc, Inc.	Delaware	100%
Amazon.com.kydc, Inc.	Delaware	100%
Amazon.com Kids, Inc.	Delaware	100%
NV Services, Inc.	Nevada	100%
Amazon.com.dedc, LLC	Delaware	100%
Amazon Services, Inc.	Nevada	100%
Amazon Technologies, Inc.	Nevada	100%
Amazon.com Int'l Sales, Inc.	Delaware	100%
Amazon Global Resources, Inc.	Delaware	100%
Amazon.com Int'l Marketplace, Inc.	Delaware	100%

Exhibit 23.1

Consent of Ernst & Young LLP
Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the (a) Registration Statement (Form S-4 No. 333-55943), as amended, pertaining to the acquisition shelf-registration of up to 30 million shares of common stock, (b) Registration Statement (Form S-8 No. 333-28763) pertaining to the 1997 Stock Option Plan of Amazon.com, Inc. and the Amended and Restated 1994 Stock Option Plan of Amazon.com, Inc., (c) Registration Statement (Form S-8 No. 333-88825) pertaining to the Convergence Corporation Stock Option Plan, (d) Registration Statement (Form S-8 No. 333-80491) pertaining to the Alexa Internet Amended and Restated 1997 Stock Option Plan, (e) Registration Statement (Form S-8 No. 333-80495) pertaining to the Accept.com Financial Services Corporation 1998 Stock Option Plan, (f) Registration Statement (Form S-3 No. 333-78797), as amended, pertaining to the shelf registration of up to $2,000,000,000 of certain securities, (g) Registration Statement (Form S-8 No. 333-78651) pertaining to the LiveBid.com 1997 Stock Option Plan and Innerlinx Technologies, Incorporated 1997 Stock Option Plan, (h) Registration Statement (Form S-8 No. 333-78653) pertaining to the eNiche Incorporated Amended and Restated 1998 Stock Option and Grant Plan, (i) Registration Statement (Form S-8 No. 333-74419) pertaining to the Amazon.com, Inc. 1999 Non-officer Employee Stock Option Plan, (j) Registration Statement (Form S-8 No. 333-63311) pertaining to the Junglee Corp. 1996 Stock Plan, the Junglee Corp. 1998 Equity Incentive Plan, the Sage Enterprises, Inc. 1997 Amended Stock Option Plan, and the Sage Enterprises, Inc. MVP Stock Option Plan, and (k) Registration Statement (Form S-8 No. 333-118818) pertaining to the Joyo.com Limited 2004 Share Option Plan, of our reports dated February 24, 2005, with respect to the consolidated financial statements and schedule of Amazon.com, Inc., Amazon.com, Inc. management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Amazon.com, Inc., included in this Annual Report (Form 10-K) for the year ended December 31, 2004.

/s/ ERNST & YOUNG LLP

Seattle, Washington
March 9, 2005

Exhibit 31.1

CERTIFICATIONS

I, Jeffrey P. Bezos, certify that:

1. I have reviewed this Form 10-K of Amazon.com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ JEFFREY P. BEZOS

Jeffrey P. Bezos
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: March 9, 2005

CERTIFICATIONS

I, Thomas J. Szkutak, certify that:

1. I have reviewed this Form 10-K of Amazon.com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ THOMAS J. SZKUTAK

Thomas J. Szkutak
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: March 9, 2005

Certification Pursuant to 18 U.S.C. Section 1350

In connection with the Annual Report of Amazon.com, Inc. (the "Company") on Form 10-K for the year ended December 31, 2004 as filed with the SEC on or about the date hereof (the "Report"), I, Jeffrey P. Bezos, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC or its staff upon request.

/s/ JEFFREY P. BEZOS

Jeffrey P. Bezos
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: March 9, 2005

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Section 1350

In connection with the Annual Report of Amazon.com, Inc. (the "Company") on Form 10-K for the year ended December 31, 2004 as filed with the Securities and Exchange Commission (the "SEC") on or about the date hereof (the "Report"), I, Thomas J. Szkutak, Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC or its staff upon request.

/s/ THOMAS J. SZKUTAK

Thomas J. Szkutak
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: March 9, 2005

Amazon Technologies, Inc. v. Jeffrey S. Wax
Opposition No. 91187118

EXHIBIT 44

UNITED STATES OF AMERICA

SECURITIES AND EXCHANGE COMMISSION

ATTESTATION

I HEREBY ATTEST

that:

Attached is a copy of, annual report on Form 10-K, for the fiscal year ended December 31, 2003, received in this Commission February 25, 2004, under the name Amazon.Com, Inc., File No. 0-22513, pursuant to the provisions of the Securities Exchange Act of 1934.

on file in this Commission

October 18, 2010
(Date)

Larry Mills
Records Officer

It is hereby certified that the Secretary of the U.S. Securities and Exchange Commission, Washington, D.C., which Commission was created by the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is official custodian of the records and files of said Commission, and all records and files created or established by the Federal Trade Commission pursuant to the provisions of the Securities Act of 1933 and transferred to this Commission in accordance with Section 210 of the Securities Exchange Act of 1934, and was such official custodian at the time of executing the above attestation, and that he/she, and persons holding the positions of Deputy Secretary, Assistant Director, Records Officer, Branch Chief of Records Management, and the Program Analyst for the Records Officer, or any one of them, are authorized to execute the above attestation.

For the Commission

Secretary

SEC 334 (10/07)

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

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2003

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)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $.01 per share

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes ☐ No ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☒ No ☐

Aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2003	$ 10,388,488,917
Number of shares of common stock outstanding as of February 18, 2004	404,330,593

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of shareholders to be held in 2004, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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AMAZON.COM, INC.

PART I

Item 1. *Business*

This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements based on expectations, estimates and projections as of the date of this filing. Actual results may differ materially from those expressed in forward-looking statements. See Item 7 of Part II—"Management's Discussion and Analysis of Financial Condition and Results of Operations—Forward-Looking Statements."

General

Amazon.com, Inc., a Fortune 500 company, commenced operations on the World Wide Web in July 1995. We seek to offer Earth's Biggest Selection and to be Earth's most customer-centric company, where customers can find and discover anything they may want to buy. We endeavor to offer our customers the lowest possible prices. Through our Merchants@ and Amazon Marketplace programs, we enable businesses and individuals to sell virtually anything to Amazon.com's millions of customers. We and other sellers offer millions of new, used, refurbished, and collectible items, in categories such as:

- Apparel, shoes and accessories
- Baby care products
- Books
- Camera and photography
- Cell phones and service
- Computers and computer add-ons
- Consumer electronics
- DVD's and videos
- Gourmet food
- Health and personal care
- Home, garden, and outdoor living products
- Jewelry and watches
- Kitchenware and housewares
- Magazine subscriptions
- Music
- Office products
- Software
- Sports & Outdoors
- Tools and hardware
- Toys

We operate six global websites: *www.amazon.com, www.amazon.co.uk, www.amazon.de, www.amazon.fr, www.amazon.co.jp,* and *www.amazon.ca.* We have organized our operations into two principal segments: North America and International. The North America segment includes the operating results of *www.amazon.com* and *www.amazon.ca.* The International segment includes the operating results of *www.amazon.co.uk, www.amazon.de, www.amazon.fr,* and *www.amazon.co.jp.* See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 15—Segment Information."

Amazon.com was incorporated in 1994 in the state of Washington and reincorporated in 1996 in the state of Delaware. Our principal corporate offices are located in Seattle, Washington. We completed our initial public offering in May 1997 and our common stock is listed on the Nasdaq National Market under the symbol "AMZN."

As used herein, "Amazon.com," "we," "our" and similar terms include Amazon.com, Inc. and its subsidiaries, unless the context indicates otherwise.

Business Strategy

Our business strategy is to offer our customers low prices, convenience, and a wide selection of merchandise.

Price

We endeavor to offer our customers the lowest prices possible. We strive to improve our operating efficiencies and to leverage our fixed costs so that we can afford to pass along these savings to our customers in the form of lower prices. We also enable third-party sellers to offer products on our site, in many instances alongside our product selection, and set their own retail prices.

Convenience

Our software engineers, computer scientists, and management team focus on continuous innovation to provide further convenience for our customers. We promote brand loyalty and repeat purchases by providing feature-rich content, a secure and trusted transaction environment, easy-to-use functionality, fast and reliable fulfillment, and timely customer service. Key features of our websites include editorial and customer reviews; manufacturer product information; Web pages tailored to individual preferences, such as recommendations and notifications; 1-Click® technology; secure payment systems; browsing; searching; and the ability to view selected interior pages and search the entire contents of many of the books we offer with our "Look Inside the Book" and "Search Inside the Book" features. Our community of online users also creates feature-rich content, including online recommendation lists, wish lists, and wedding and baby registries.

We endeavor to fulfill customer orders quickly, and to provide intuitive self-service features that assist our customers when they have questions. We communicate our fulfillment promise in several ways, such as presenting up-to-date inventory availability information, delivery date estimates, and options for expedited delivery, as well as delivery shipment notifications. Additionally, customers can use the "your account" website features to track order and shipment status, review estimated delivery dates, cancel unshipped items, change delivery instructions and payment options, combine orders, edit gift options, and return items. In the event our customers would like to contact customer service, our representatives may be contacted by e-mail or by phone.

We fulfill customer orders in a number of ways, including through our six U.S. and three international fulfillment centers; through fulfillment centers operated under co-sourcing arrangements, including our fulfillment center supporting *www.amazon.co.jp*; through outsourced fulfillment providers, including our fulfillment provider supporting *www.amazon.ca;* and through other third-party fulfillment arrangements. We operate six customer service centers and have several co-sourcing arrangements to provide additional customer service. See Item 2 of Part I, "Properties," for additional information about fulfillment centers and customer service locations.

Selection

To provide the widest possible selection for our customers, we have designed our websites to enable millions of unique products to be sold by us and by third parties across many product categories.

Amazon.com Retail

We sell a broad range of products that we purchase from manufacturers and distributors and deliver to our customers. Additionally, through our Syndicated Stores program, we utilize our e-commerce services, features, and technologies to sell our products through other businesses' websites. Under our syndicated stores arrangements, we generally own the inventory, set prices, and are responsible for fulfillment and customer service, and the other business earns a sales commission on product sales.

Third-Party Sellers

We offer Amazon Marketplace and Merchants@ programs that enable third parties to integrate their products on our websites, allow customers to shop for products owned by third parties using our features and technologies, and allow individuals to complete transactions that include multiple sellers in a single checkout process. We are not the seller of record in these third-party seller transactions, but instead earn fixed fees, sales commissions, per-unit activity fees, or some combination thereof.

Amazon Marketplace generally serves individuals and small businesses, enabling them to offer their products for sale on our websites alongside our products or products made available by other third-party sellers. Our Merchants@ program generally serves larger companies and is primarily concentrated on expanding the selection of new products available on our websites. We also sometimes offer fulfillment-related services under our Merchants@ program.

Other Services

Through our Merchant.com program we utilize our e-commerce services, features, and technologies to operate another business's website, sell its products under its brand name and URL, and sometimes offer fulfillment services (an example is *www.target.com*). We also provide technology services, such as search, browse and personalization, and other marketing and promotional services, such as our co-branded credit card.

Marketing and Promotion

Our marketing strategy is designed to strengthen and broaden the Amazon.com brand name, increase customer traffic to our websites, encourage customers to shop in many product categories, promote repeat purchases, and develop incremental product and service revenue opportunities. First and foremost, our best marketing efforts are focused on improving the customer experience, which drives word-of-mouth promotion and repeat customer visits. We also deliver personalized Web pages and services and employ a variety of media, business development activities, and promotional methods to achieve these goals. We employ various means of online and traditional advertising, including sponsored links, e-mail, print media, and direct marketing, television, and other offline advertising. We also participate in cooperative advertising arrangements with certain of our vendors.

Our Associates program directs customers to our websites by enabling associated websites to make our products available to their audiences with fulfillment performed by us. In addition, we offer an everyday free shipping option at *www.amazon.com* and *www.amazon.ca* for certain orders that exceed a specific amount, and offer similar options for our internationally-focused websites. Although marketing expenses do not include our free shipping offers or promotional offers, we view such offers as an effective marketing tool.

Technology

Using a combination of our own proprietary technologies and commercially available, licensed technologies, we have implemented numerous features that simplify and improve the customer shopping experience, enable third parties to sell on our platform, and facilitate our fulfillment and customer service operations. Our current strategy is to focus our development efforts on creating and enhancing the specialized, proprietary software that is unique to our business, and to license or acquire commercially-developed technology for other applications where available and appropriate.

We use a set of applications for accepting and validating customer orders, placing and tracking orders with suppliers, managing and assigning inventory to customer orders, and ensuring proper shipment of products to customers. Our transaction-processing systems handle millions of items, a number of different status inquiries, gift-wrapping requests, and multiple shipment methods. These systems allow the customer to choose whether to receive single or several shipments based on availability and to track the progress of each order. These applications also manage the process of accepting, authorizing, and charging customer credit cards.

Competition

The environment for our products and services is intensely competitive. Our current and potential competitors include: (1) physical-world retailers, catalog retailers, publishers, distributors and manufacturers of our products, many of which possess significant brand awareness, sales volume, and customer bases, and some of which currently sell, or may sell, products or services through the Internet, mail order, or direct marketing; (2) other online e-commerce sites; (3) a number of indirect competitors, including media companies, Web portals, and Web search engines that are involved in online commerce, either directly or in collaboration with other retailers; and (4) companies that provide e-commerce services, including website developers and third-party fulfillment and customer-service providers. We believe that the principal competitive factors in our market segments include selection, price, availability, convenience, information, discovery, brand recognition, personalized services, accessibility, customer service, reliability, speed of fulfillment, ease of use, and ability to adapt to changing conditions, as well as our customers' overall trust in the entire experience in transactions with us or facilitated by us on behalf of third-party sellers. For services we offer to business and individual sellers, additional competitive factors include the quality of our services and tools and the speed of performance for our services. As the market segments in which we operate continue to grow, other companies may also enter into business combinations or alliances that strengthen their competitive positions.

Intellectual Property

We regard our trademarks, service marks, copyrights, patents, domain names, trade dress, trade secrets, proprietary technologies, and similar intellectual property as critical to our success, and we rely on trademark, copyright and patent law, trade-secret protection, and confidentiality and/or license agreements with our employees, customers, partners, and others to protect our proprietary rights. We have registered a number of domain names and been issued a number of trademarks, service marks, patents, and copyrights by U.S. and foreign governmental authorities. We also have applied for the registration of other trademarks, service marks, domain names, and copyrights in the U.S. and internationally, and we have filed U.S. and international patent applications covering certain of our proprietary technology. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights, such as trademarks, patents, technologies or copyrighted materials, to third parties.

Seasonality

Our business is affected by seasonality, which historically has resulted in higher sales volume during our fourth quarter.

Employees

We employed approximately 7,800 full-time and part-time employees at December 31, 2003. However, employment levels fluctuate due to seasonal factors affecting our business. We also employ independent contractors and temporary personnel on a seasonal basis. None of our employees is represented by a labor union and we consider our employee relations to be good. Competition for qualified personnel in our industry is intense, particularly for software engineers, computer scientists, and other technical staff. We believe that our future success will depend in part on our continued ability to attract, hire, and retain qualified personnel.

Available Information

Our investor relations website is *www.amazon.com/ir*. We make available on this website under "Financial Documents," free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the U.S. Securities and Exchange Commission ("SEC").

Additional Factors That May Affect Future Results

The following risk factors and other information included in this Annual 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 Have an Accumulated Deficit and May Incur Additional Losses

We have incurred significant net losses since we began doing business. As of December 31, 2003, we had an accumulated deficit of $2.97 billion and our stockholders' equity was a deficit of $1.04 billion. We have incurred substantial operating losses since our inception, and although we earned a small amount of net income in 2003, we may incur losses again in the future.

We Have Significant Indebtedness

As of December 31, 2003, we had long-term indebtedness of $1.95 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 in 2003, we may incur substantial additional debt in the future. Our indebtedness could limit our ability to obtain additional financing for working capital, capital expenditures, debt service requirements, 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.

See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 17—Subsequent Events."

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 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 may further intensify the competitive nature of online retail. 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 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 Merchant.com 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 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 our commercial 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 these 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 present and future acquisitions, business combinations, joint ventures, and investments create additional risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- difficulty assimilating the operations, technology, and personnel of combined companies;
- problems retaining key technical and managerial personnel; and
- additional operating losses and expenses of acquired businesses.

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 has been 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 equity investments" 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 December 31, 2003, our recorded basis in equity securities was $23 million, including $9 million classified as "Marketable securities" and $15 million classified as "Other equity investments."

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 U.S. 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 each 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 a decline in our shipping margins 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 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 will decline during the first three months following year-end, which will result in a decline in the amount of cash, cash equivalents, and marketable securities on hand.

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. Our expenses and investments are to a large extent fixed. 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 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;
- our ability to acquire merchandise, manage inventory, and fulfill orders;
- the introduction by our competitors of websites, products, services, or improvements;
- changes in usage of the Internet and online services and consumer acceptance of the Internet and e-commerce;
- timing 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;
- 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 promotions; and
- an increase in the prices of fuel and gasoline, which are used in the transportation of packages, as well as an increase in the prices of other energy products, primarily natural gas and electricity, which are used in our operating facilities.

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 Have Foreign Exchange Risk

The results of operations 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 transaction gains or losses on the remeasurement of intercompany balances.

In addition, our 6.875% Convertible Subordinated Notes due 2010 ("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 "Remeasurement of 6.875% PEACS and other" on our consolidated statements of operations. Furthermore, we hold cash equivalents and marketable securities in Euros, British Pounds and 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 Planned Future Growth Will Place a Significant Strain on our Management, Operational, and Financial Resources

We have rapidly and significantly expanded our operations and will endeavor to expand further to pursue growth of our product and service offerings and customer base. Such growth will continue to place a significant strain on our management, operational, and financial resources. We also need to hire, train, and manage our employee base. Our current and planned personnel, systems, procedures, and controls may not be adequate to support and effectively manage our future operations, 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.

In addition, we do not expect to benefit in our newer market segments from the first-to-market advantage that we experienced in the 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 our customers may not favorably receive our new businesses. To the extent we pursue commercial agreements and/or strategic alliances to facilitate new product or service activities, the agreements and/or alliances may not be successful. If any of this were to occur, it could damage our reputation and negatively affect revenue growth.

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 directly affects the volume of goods we sell and the services we offer and thus affects our net sales. We experience occasional system interruptions that make our websites unavailable or 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 additional software and hardware and upgrade in an effective manner our systems and network infrastructure, it could cause system interruption 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 to remedy.

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

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 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);
- import or export licensing requirements;
- limitations on the repatriation of funds;
- difficulty in obtaining distribution and support;
- nationalization;
- longer receivable cycles;
- consumer protection laws and restrictions on pricing or discounts;
- lower level of adoption or use of the Internet and other technologies vital to our business and the lack of appropriate infrastructure to support widespread Internet usage;
- lower level of credit card usage and increased payment risk;
- difficulty in developing and simultaneously managing a larger number of unique foreign operations as a result of distance, language, and cultural differences;
- 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 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.

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 is particularly difficult to forecast product demand accurately. A failure to optimize inventory within our fulfillment network will harm our shipping margins 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 Merchants@ program relationships with Toysrus.com, Babiesrus.com, Target, and other companies, these parties identify, buy, manage, 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 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.

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, and warehousing, fulfillment, and distribution capacity. 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 each 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. Finally, our ability to receive inbound inventory efficiently or ship completed orders to customers may be negatively affected by a number of factors, including dependence on a limited number of shipping companies, inclement weather, fire, flood, power loss, earthquakes, labor disputes, acts of war or terrorism, or acts of God.

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.

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. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, we cannot be certain that the steps we take to protect our intellectual property will adequately protect our rights or that others will not independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights.

Third parties that license our proprietary rights may take actions that diminish the value of our proprietary rights or reputation. In addition, the steps we take to protect our proprietary rights may not be adequate and third parties may infringe or misappropriate our copyrights, trademarks, trade dress, patents, and similar proprietary rights. Other parties may claim that we infringed 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, as an e-commerce company, we have 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
- 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. In the first quarter of 2001, we offered a limited non-compulsory exchange of employee stock options. This option exchange offer resulted in variable accounting treatment for certain of our stock options. Additionally, all options granted on or after January 1, 2003 are subject to variable accounting treatment. Variable accounting treatment will result in unpredictable stock-based compensation expense dependent on fluctuations in quoted prices for our common stock. In late 2002, we implemented a restricted stock unit plan, which will be our primary vehicle for stock-based compensation going forward. Restricted stock and restricted stock units, not subject to variable accounting, are measured at fair value on the date of grant based on the number of shares granted and the quoted price of the common stock, which will be recognized as compensation expense over the corresponding service term.

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, user privacy, data protection, pricing, content, copyrights, distribution, electronic contracts and other communications, consumer protection, the provision of online payment services, broadband residential Internet access, 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.

We May Be Subject to Liability for Past Sales and Our Future Sales May Decrease

In accordance with current industry practice, we do not collect sales taxes or other taxes with respect to shipments of most of our goods into states other than Washington, North Dakota, and in April 2004, Kansas. 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. We collect Value Added Tax, or VAT, for products that are ordered on *www.amazon.co.uk, www.amazon.de,* and *www.amazon.fr* and delivered in European Union, or EU, member countries. As of July 1, 2003, we began collecting VAT with respect to certain of our "electronically supplied services," including digital downloads and marketplace services, provided to certain EU residents. We also collect Japanese consumption tax for products that are ordered on *www.amazon.co.jp* and delivered in Japan. In addition, Canadian consumption taxes are collected on sales of products that are ordered on *www.amazon.ca* and delivered in Canada. 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. 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 states other than Washington, North Dakota, and Kansas. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us and could decrease our future sales.

We Source a Significant Portion of Our Inventory from a Few Vendors

Although we continue to increase our direct purchasing from manufacturers, we source a significant amount of inventory from relatively few vendors. However, no vendor accounts for 10% or more of our inventory purchases. 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 suppliers and third party sellers do not indemnify us from product liability.

We Could Be Liable for Breaches of Security on Our Website and Fraudulent Activities of Users of Our Payments Program

A fundamental requirement for e-commerce is the secure transmission of confidential information over public networks. 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.

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. We guarantee payments made through our payments program available to sellers on Marketplace and certain other programs up to certain limits for buyers, and we may be unable to prevent users from fraudulently collecting payments when goods may not be shipped to a buyer. As our payments program grows, our liability risk will increase. Any costs we incur as a result of liability because of our payments program's 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.

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.

The Internet as a Medium for Commerce Is Uncertain

Consumer use of the Internet as a medium for commerce is a recent phenomenon and is subject to a high level of uncertainty. While the number of Internet users has been rising, the Internet infrastructure may not expand fast enough to meet the increased levels of demand. If use of the Internet as a medium for commerce does not continue to grow or grows at a slower rate than we anticipate, our sales would be lower than expected and our business would be harmed.

We Could Be Liable for Unlawful or Fraudulent Activities by Users of Our Merchants@, Marketplace, Merchant.com, and Certain Other Programs

We may be unable to prevent users of our Merchants@, Marketplace, Merchant.com, and certain other programs from selling unlawful goods, or from selling goods in an unlawful manner. We may face civil or criminal liability for unlawful and fraudulent activities by our users under U.S. laws and the laws and regulations of other countries. In addition, if we are unsuccessful in preventing our users from providing content that is either illegal or that violates the proprietary rights of others, it may result in liability to us. Any costs we incur as a result of liability relating to the sale of unlawful goods, the unlawful sale of goods, the fraudulent receipt of goods, or the fraudulent collection of payments could harm our business. In running our Merchants@, Marketplace, Merchant.com, and other programs, we rely on sellers to make accurate representations and provide reliable delivery, and on buyers to pay the agreed purchase price. To the extent we expand our guarantee program, this may create additional liability for us.

Executive Officers and Directors

The following tables set forth certain information regarding our Executive Officers and Directors as of February 18, 2004:

Executive Officers

Name	Age	Position
Jeffrey P. Bezos	40	President, Chief Executive Officer, and Chairman of the Board
Richard L. Dalzell	46	Senior Vice President, Worldwide Architecture and Platform Software, and Chief Information Officer
Jason Kilar	32	Senior Vice President, Worldwide Application Software
Mark S. Peek	46	Vice President and Chief Accounting Officer
Diego Piacentini	43	Senior Vice President, Worldwide Retail and Marketing
Thomas J. Szkutak	43	Senior Vice President and Chief Financial Officer
Jeffrey A. Wilke	37	Senior Vice President, Worldwide Operations and Customer Service
L. Michelle Wilson	41	Senior Vice President, General Counsel, and Secretary

Jeffrey P. Bezos. Mr. Bezos has been Chairman of the Board of Amazon.com since founding it in 1994 and Chief Executive Officer since May 1996. Mr. Bezos served as President from founding until June 1999 and again from October 2000 to the present.

Richard L. Dalzell. Mr. Dalzell has served as Senior Vice President, Worldwide Architecture and Platform Software, and Chief Information Officer since November 2001. From October 2000 until November 2001, Mr. Dalzell was Senior Vice President and Chief Information Officer and prior to that, from joining Amazon.com in August 1997 until October 2000, he was Vice President and Chief Information Officer.

Jason Kilar. Mr. Kilar has served as Senior Vice President, Worldwide Application Software, since May 2003. From February 2002 to May 2003, he served as Vice President, Worldwide Application Software. From October 2001 until February 2002, he served as Vice President, Marketplace, and from February 2001 until October 2001, he served as Vice President, Books, Music, and Video & DVD. Mr. Kilar joined Amazon.com in May, 1997 as a Product Manager.

Mark S. Peek. Mr. Peek has served as Vice President and Chief Accounting Officer since July 2002. From November 2000 to July 2002, he served as Vice President, Financial Planning and Analysis, and from April 2000 to November 2000, he served as Vice President, Finance, and Chief Accounting Officer. Prior to joining Amazon.com, Mr. Peek was an audit partner with Deloitte & Touche.

Diego Piacentini. Mr. Piacentini has served as Senior Vice President, Worldwide Retail and Marketing, since November 2001. From joining Amazon.com in February 2000 until November 2001, Mr. Piacentini was Senior Vice President and General Manager, International. Prior to joining Amazon.com, Mr. Piacentini was Vice President and General Manager, Europe, of Apple Computer, Inc., with responsibility for Apple Computer's operations in Europe, the Middle East, and Africa.

Thomas J. Szkutak. Mr. Szkutak has served as Senior Vice President and Chief Financial Officer since November 2002. Previously, Mr. Szkutak held a variety of positions at General Electric Co., including Chief Financial Officer of GE Lighting from September 2001 to September 2002, Finance Director of GE Plastics Europe from March 1999 to September 2001, and Executive Vice President—Finance of GE Asset Management (formerly known as GE Investments) from May 1997 to March 1999.

Jeffrey A. Wilke. Mr. Wilke has served as Senior Vice President, Worldwide Operations and Customer Service, since January 2002. From October 2000 until January 2002, Mr. Wilke was Senior Vice President, Operations, and prior to that he had been Vice President and General Manager, Operations, since joining Amazon.com in September 1999. Previously, Mr. Wilke held a variety of positions at AlliedSignal, including Vice President and General Manager of the Pharmaceutical Fine Chemicals unit from March 1999 to September 1999 and General Manager of the Carbon Materials and Technologies unit from August 1997 to February 1999.

L. Michelle Wilson. Ms. Wilson has served as Senior Vice President, General Counsel, and Secretary since June 2003. She served as Senior Vice President, Human Resources, General Counsel, and Secretary from March 2001 until June 2003 and as Vice President, General Counsel, and Secretary from July 1999 until March 2001. Ms. Wilson joined Amazon.com in March 1999 as Associate General Counsel, Mergers and Acquisitions and Finance. Prior to joining Amazon.com, she was a partner in the law firm of Perkins Coie LLP.

Board of Directors

Name	Age	Position
Jeffrey P. Bezos	40	President, Chief Executive Officer, and Chairman of the Board
Tom A. Alberg	64	Managing Director of Madrona Venture Group
L. John Doerr	52	General Partner, Kleiner Perkins Caufield & Byers
Thomas O. Ryder	59	Chairman and CEO of Reader's Digest Association, Inc.
Patricia Q. Stonesifer	47	President and Co-Chair of the Bill & Melinda Gates Foundation
William B. Gordon	54	Executive Vice President and Chief Creative Officer of Electronic Arts, Inc.

Item 2. ***Properties***

We do not own any real estate. Our principal office facilities in the U.S. are located in several leased facilities in Seattle, Washington under leases that expire at various times through April 2011. Our corporate office facilities, excluding customer service office space, in the U.S. comprise a total of 577,000 square feet. Additionally, we have 309,000 square feet of office space that is subleased or is vacant under lease agreements that expire at various times through April 2011.

Our U.S. warehousing and fulfillment operations are housed in six fulfillment centers located in New Castle, Delaware; Fernley, Nevada; Coffeyville, Kansas; Lexington and Campbellsville, Kentucky; and Grand Forks, North Dakota. These fulfillment centers comprise a total of approximately 3.2 million square feet. Our fulfillment center leases expire from 2005 through 2015.

We also lease six facilities located near our fulfillment centers, comprising approximately 1.2 million square feet, which we use for off-site storage and shipping. These offsite storage and shipping facilities are under relatively short-term lease agreements that expire at various times through July 2004 and one longer-term lease through June 2008; following expiration, we intend to renew certain of these leases or consolidate into new offsite facilities, or both.

Our U.S. customer service operations occupy approximately 77,000 square feet of office space and are located in Tacoma, Washington; Huntington, West Virginia; and Grand Forks, North Dakota. The lease terms of these facilities expire from 2006 to 2008.

Our data-center facilities have 120,000 combined square feet, including approximately 40,000 square feet of vacant space at one facility. These facilities are under leases that expire in 2004 and 2009.

We lease additional properties outside the U.S., including approximately 135,000 square feet of corporate office space in Germany, France, Japan, and the United Kingdom, which excludes approximately 40,000 square feet of vacant office space in Germany. We also lease approximately 1 million combined square feet of available fulfillment center space in Germany, France, and the United Kingdom; and approximately 66,000 combined square feet of customer service space in Germany, Japan, and the United Kingdom. The fulfillment centers in Germany, the United Kingdom, and France are located in Bad Hersfeld, Marston Gate, and Orleans, and the lease terms expire in December 2009, October 2025, and March 2009.

We believe our properties are suitable and adequate for our present needs, and we periodically evaluate whether additional facilities are necessary.

Item 3. ***Legal Proceedings***

See, Item 8 of Part II, "Financial Statements and Supplemental Data—Note 7—Commitments and Contingencies—Legal Proceedings."

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

No matters were submitted for a vote of our shareholders during the fourth quarter of 2003.

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PART II

Item 5. *Market for the Registrant's Common Stock and Related Shareholder Matters*

Market Information

Our common stock is traded on the Nasdaq National Market under the symbol "AMZN." The following table sets forth the high and low intraday sale prices for the common stock for the periods indicated, as reported by the Nasdaq National Market.

	High	Low
Year ended December 31, 2002		
First Quarter	$16.96	$ 9.03
Second Quarter	20.40	12.52
Third Quarter	17.93	12.26
Fourth Quarter	25.00	16.01
Year ended December 31, 2003		
First Quarter	$28.04	$18.55
Second Quarter	37.24	24.13
Third Quarter	51.30	34.00
Fourth Quarter	61.15	47.00

Holders

As of February 18, 2004, there were 4,126 shareholders of record of our common stock, although there is a much larger number of beneficial owners.

Dividends

We have never declared or paid cash dividends on our common stock. See Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

Recent Sales of Unregistered Securities

None.

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Item 6. *Selected Consolidated Financial Data*

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto in Item 8 of Part II, "Financial Statements and Supplementary Data," and the information contained in Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations." Historical results are not necessarily indicative of future results.

	As of and for the Years Ended December 31,				
	2003	2002	2001	2000	1999
	(in thousands, except per share data)				
Net cash provided by (used in) operating activities	$ 392,022	$ 174,291	$ (119,782)	$ (130,442)	$ (90,875)
Net sales	5,263,699	3,932,936	3,122,433	2,761,983	1,639,839
Gross profit	1,257,168	992,618	798,558	655,777	290,645
Income (loss) from operations	270,595	64,124	(412,257)	(863,880)	(605,755)
Interest income	21,955	23,687	29,103	40,821	45,451
Interest expense	(129,979)	(142,925)	(139,232)	(130,921)	(84,566)
Net income (loss)	35,282	(149,132)	(567,277)	(1,411,273)	(719,968)
Basic earnings (loss) per share (1)	$ 0.09	$ (0.39)	$ (1.56)	$ (4.02)	$ (2.20)
Diluted earnings (loss) per share (1)	$ 0.08	$ (0.39)	$ (1.56)	$ (4.02)	$ (2.20)
Weighted average shares used in computation of basic earnings (loss) per share (1)	395,479	378,363	364,211	350,873	326,753
Weighted average shares used in computation of diluted earnings (loss) per share (1)	419,352	378,363	364,211	350,873	326,753
Balance Sheet and Other Data:					
Cash and cash equivalents	$ 1,102,273	$ 738,254	$ 540,282	$ 822,435	$ 133,309
Marketable securities	292,550	562,715	456,303	278,087	572,879
Total assets	2,162,033	1,990,449	1,637,547	2,135,169	2,465,850
Long-term debt and other	1,945,439	2,277,305	2,156,133	2,127,464	1,466,338
Stockholders' Equity (Deficit)	(1,036,107)	(1,352,814)	(1,440,000)	(967,251)	266,278

(1) For further discussion of earnings (loss) per share, see Item 8 of Part II, "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies" and "—Note 9—Earnings (Loss) Per Share."

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

This section should be read in conjunction with "Forward-Looking Statements" below, as well as Item 1 of Part 1, "Business—Additional Factors That May Affect Future Results," and Item 8 of Part II, "Financial Statements and Supplementary Data."

Overview

Our primary source of revenue is the sale of a wide range of products and services to customers of our global websites. The products offered on our websites include products we have purchased from distributors and manufacturers and products sold by third parties on our websites. Generally, we recognize revenue as the seller of record from items we offer from our inventory and recognize our net share of revenue of items offered by third parties.

Our financial focus is on long-term, sustainable growth in free cash flow[1]. We also seek to minimize shareholder dilution while maintaining the flexibility to issue shares for strategic purposes, such as financings and aligning employee interests with shareholders.

Free cash flow is driven primarily by increasing consolidated segment operating profit and efficiently managing working capital and capital expenditures. Increases in consolidated segment operating profit result from increases in sales through our websites and a focus on keeping costs low. To increase sales, we focus on improving all aspects of the customer experience, including lowering prices, improving availability, increasing selection, expanding product information, improving ease of use, and earning customer trust. Our price reductions take several forms: we reduce the sales prices of products we sell, we recruit third-party sellers to compete with us on product detail pages, and we reduce or eliminate the cost of shipping to the consumer.

We moved to restricted stock units as our primary vehicle for equity compensation in late 2002. Restricted stock units result in charges to our income statement; however, we believe they better align the interests of our shareholders and employees. Total shares outstanding plus employee stock awards are essentially unchanged at the end of 2003 compared to 2002.

We leverage our fixed customer experience costs and work to reduce our variable cost per unit. Our customer experience costs, specifically the costs necessary to build, enhance, and add features to our websites and build and optimize our fulfillment centers, are largely fixed costs. The customer experience costs that remain variable as a percentage of sales include product costs, credit-card processing fees, picking, packaging, and preparing orders for shipment, transportation, customer service support, and certain aspects of our marketing costs. We focus on maintaining a lean culture by reducing defects in our processes, and obtaining volume discounts from suppliers to decrease our variable costs on a per unit basis and enable us to lower prices for customers.

Because we are able to turn our inventory quickly, we have a negative operating cycle that is a source of cash flow[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 18, 19, and 16 for 2003, 2002, and 2001. We expect some variability in inventory turnover over time since it is affected by several factors, including 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 50, 52, and 49 at December 31, 2003, 2002, and 2001. We expect some variability in accounts payable days over time since they are affected by several factors, including the mix of product sales, the mix of suppliers, 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 and software engineers to continue to improve our process efficiency and enhance the customer experience on our websites. 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 broad-band service to the home, and the advances of wireless connectivity will continue to improve the consumer experience on the Internet and increase the ubiquity of computers 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.

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1. Free cash flow 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 statements of cash flows.
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 cost of sales to average inventory.
4. Accounts payable days, calculated as the quotient of accounts payable to cost of sales, multiplied by the number of days in the period.

Finally, we want to emphasize that we do not believe that our reported net income for the year ended December 31, 2003 should be viewed as a material positive event or should be considered predictive of future results. As we discuss in Item 8 of Part II, "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies—Foreign Currencies," had it not been for our decision to settle intercompany balances denominated in foreign currencies, we would have reported a small net loss for 2003. Also, as our financial reporting currency is the U.S. Dollar, our total revenue, profit, and free cash flow has significantly benefited each of the past two years from weakness in the U.S. Dollar in comparison to the currencies of our faster-growing international websites. While we believe that our increasing diversification beyond the U.S. economy through our fast growing international businesses benefits our shareholders, it is important to evaluate our growth rates after the effect of currency changes. For example, although we grew 34% during 2003, holding currency exchange constant with the prior year our growth would have been 28%. In the future, this trend may reverse, and our consolidated U.S. Dollar revenue growth rates would be less than our local-currency growth rates.

For a description of, and additional information about, each line item summarized below, refer to Item 8 of Part II, "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies."

Forward-Looking Statements

This Annual Report on Form 10-K 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 industry prospects and future results of operations or financial position, made in this Annual Report on Form 10-K 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, the rate of growth of the economy in general and of the Internet and online commerce, customer spending patterns, world events, the amount that we invest 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, risks of inventory management, the degree to which we enter into commercial agreements and strategic transactions and maintain and develop commercial relationships, foreign exchange risks, seasonality, international growth and expansion, 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 1 of Part I, "Business—Additional Factors That May Affect Future Results," which, along with the following discussion, describes some, but not all, of the factors that could cause actual results to differ significantly from management's expectations.

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 the company 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." 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.

Significant Accounting Policies

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 to the carrier 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: (1) the delivered item has value to the customer on a standalone basis; (2) there is objective and reliable evidence of the fair value of undelivered items; and (3) delivery of any undelivered item is probable.

We evaluate the criteria outlined in Emerging Issues Task Force ("EITF") Issue No. 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. When we are the primary obligor 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 the primary obligor and amounts earned are determined using a fixed percentage, a fixed-payment schedule, or a combination of the two, we record the net amounts as commissions earned.

Product sales, 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 a sales contract that provides 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.

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 presented as a net amount in "Net sales."

Commissions and per-unit fees received from third-party sellers and amounts earned through our Merchant.com program are recognized when the item is sold by the third-party seller and our collectibility is reasonably assured. We record an allowance for estimated refunds on such commissions using historical experience. We also record an allowance, using historical experience, for losses we incur on our payment guarantee from disputes by customers against third-party sellers.

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 record a valuation allowance to adjust the carrying amount of our inventories to lower of cost or market value.

Currency Effect on Intercompany Balances

A provision of Statement of Financial Accounting Standards ("SFAS") No. 52, *Foreign Currency Translation*, requires that gains and losses arising from intercompany foreign currency transactions considered

long-term investments, where settlement is not planned or anticipated in the foreseeable future, be excluded in the determination of net income. Our international operations are financed, in part, by the U.S. parent company. Currency adjustments for these intercompany balances were historically recorded to equity as translation adjustments and not included in the determination of net income because we intended to permanently invest such amounts. During the fourth quarter of 2003, we made the decision that these amounts would be repaid among the entities and, accordingly, upon consolidation any exchange gain or loss arising from remeasurement of intercompany balances is required to be recorded in the determination of net income. The effect for the fourth quarter of 2003 and the year ended December 31, 2003 was to increase net income by $36 million. The effect of this treatment was very significant to our net income for the year and for the quarter. Had we not changed our intent as to the settlement of these intercompany balances, we would have had a net loss for 2003 and our net income for the fourth quarter of 2003 would have been reduced by almost 50%. See Item 8 of Part II "Financial Statements and Supplementary Data—Note 12—Remeasurement of 6.875% PEACS and Other" for further discussion.

Restructuring Estimates

Restructuring-related liabilities include estimates for, among other things, anticipated disposition of lease obligations. Key variables in determining such estimates include anticipated timing of sublease rentals, estimates of sublease rental payment amounts and tenant improvement costs, and estimates for brokerage and other related costs. Additionally, we may determine that certain of the office space previously vacated as part of our 2001 restructuring, which we have been unable to sublease due to poor real estate market conditions, may be necessary for our future expansion needs. We periodically evaluate and, if necessary, adjust our estimates based on currently-available information. If we elect to utilize this office space, in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, we will adjust our restructuring-related liability and classify future payments to "General and administrative" on the consolidated statements of operations.

Liquidity and Capital Resources

Our principal sources of liquidity are cash flows generated from operations and our cash, cash equivalents, and marketable securities which were $1.40 billion, $1.30 billion, and $997 million at December 31, 2003, 2002 and 2001. Additionally, we received cash from exercises of employee stock awards of $163 million, $122 million, and $15 million in 2003, 2002, and 2001. We expect that stock award exercises will decline as a source of cash as a result of our decision to use restricted stock unit awards as our primary form of stock-based compensation. At December 31, 2003 and 2002, we held $764 million and $398 million in foreign currencies, primarily Euros, British Pounds, and Yen.

During 2003, our cash, cash equivalents, and marketable securities were utilized to redeem our 10% Senior Discount Notes due 2008 ("10% Senior Discount Notes") and a portion of our 4.75% Convertible Subordinated Notes due 2009 ("4.75% Convertible Subordinated Notes"). Total redemption payments, including redemption premiums, totaled $483 million. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 6—Long-Term Debt and Other."

Our operating cash flows result primarily from cash received from our customers and third-party sellers, offset by cash payments we make to suppliers of products and services, employee compensation, and interest payments on our long-term debt obligations. Cash received from customers and third-party sellers 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. We generally experience a net cash outflow during the first quarter of each year, as we pay suppliers for inventory that was purchased and sold in the fourth quarter. At the end of 2003, we held $294 million of products in inventories, an increase of $91 million in comparison to the prior year. The increase in inventories corresponds with our efforts to add product categories, increase selection and availability in both existing and new product categories, take advantage of additional discounts offered to us by suppliers, and the effect of foreign exchange rates. Additionally, our

accounts payable at December 31, 2003 increased $202 million over the prior year end corresponding with increased sales volume.

Since our 6.875% PEACS, which are due in 2010, are denominated in Euros, our U.S. Dollar equivalent interest payments fluctuate with the Euro to U.S. Dollar exchange rate. In 2003, the U.S. Dollar weakened considerably relative to the Euro resulting in higher U.S. Dollar equivalent interest payments. Additionally, in 2003 we began accruing interest on our 10% Senior Discount Notes and paid $2 million of interest when we repaid the full principal amount. We also made interest payments of $3 million associated with the $200 million partial redemption of our 4.75% Convertible Subordinated Notes; this payment was otherwise scheduled to be paid in 2004. We currently do not hedge our exposure to foreign currency effects on our interest payments relating to the 6.875% PEACS, and, as a result, any fluctuations in the exchange rate will have an effect on our interest expense. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 6—Long-Term Debt and Other."

Cash provided by (used in) investing activities corresponds with our buying and selling of marketable securities and purchases of fixed assets, including internal-use software costs. Cash provided by investing activities was $237 million during 2003, while cash used in investing activities was $122 million and $253 million during 2002 and 2001. Our capital expenditures were $46 million, $39 million, and $50 million for 2003, 2002, and 2001. We believe our expenditures for repairs and improvements are sufficient to keep our facilities and equipment in suitable operating condition.

Cash provided by (used in) financing activities consists primarily of cash proceeds from exercises of stock options, repayment of long-term debt, and repayment of capital lease obligations. Cash used in financing activities was $332 million during 2003 resulting primarily from repayments of long-term debt obligations. Cash provided by financing activities was $107 million during 2002 and 2001. We expect cash proceeds from exercises of employee stock options to decline over time as we plan to continue issuing restricted stock units as our primary vehicle for employee stock-based awards.

In January 2004, our Board of Directors authorized a debt repurchase program pursuant to which we may from time to time repurchase (through open market repurchases or private transactions), redeem, or otherwise retire up to an aggregate of $500 million of our outstanding 4.75% Convertible Subordinated Notes and 6.875% PEACS. In addition to this debt repurchase program, on February 26, 2004, we will redeem $150 million of our 4.75% Convertible Subordinated Notes.

The following summarizes our principal contractual commitments as of December 31, 2003 (in thousands):

	2004	2005	2006	2007	2008	Thereafter	Total
Restructuring-related commitments:							
Operating leases, net of estimated sublease income	$ 9,577	$ 4,998	$ 3,421	$ 3,356	$ 2,691	$ 5,300	$ 29,343
Other	897	300	—	—	—	—	1,197
Restructuring-related commitments	10,474	5,298	3,421	3,356	2,691	5,300	30,540
Other commitments:							
Debt principal and other (1)(2)	3,013	74	—	—	246	1,931,160	1,934,493
Debt interest (1)(2)	109,656	109,656	109,656	109,656	109,656	144,517	692,797
Capital leases	1,678	868	341	—	—	—	2,887
Operating leases (3)	51,498	43,323	42,391	39,100	38,181	131,040	345,533
Purchase obligations (4)	187,881	—	—	—	—	—	187,881
Other commitments	353,726	153,921	152,388	148,756	148,083	2,206,717	3,163,591
Total commitments	$364,200	$159,219	$155,809	$152,112	$150,774	$2,212,017	$3,194,131

(1) The principal payment due in 2010 and the annual interest payments due under our 6.875% PEACS fluctuate based on the Euro/U.S. Dollar exchange ratio. At December 31, 2003, the Euro to U.S. Dollar exchange rate was 1.260. Due to

fluctuations in the Euro/U.S. Dollar exchange ratio, our principal debt obligation under this instrument since issuance has increased by $197 million through December 31, 2003. We cannot predict the performance of the U.S. Dollar relative to the Euro.
(2) See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 17—Subsequent Events."
(3) Pursuant to SFAS No. 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 No. 13 they are not reflected on the balance sheet. As of December 31, 2003, we have remaining obligations under operating leases for equipment and real estate of $346 million. If we had applied to our equipment-related operating leases the same convention used for capital leases, which, however, would not be in accordance with GAAP, we would have recorded approximately $76 million of additional assets and obligations on our balance sheet at December 31, 2003.
(4) Consists of legally-binding commitments to purchase inventory. Legally-binding commitments associated with non-inventory purchases are not significant.

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 1 of Part I, "Business—Additional Factors that May Affect Future Results." 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 (and our Board of Directors has authorized the debt repurchase program discussed above). 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. We do not currently have a line-of-credit, and there can be no assurance that lines-of-credit or other financing instruments will be available in amounts or on terms acceptable to us, if at all.

Results of Operations

Segment Operating Income (Loss)

	Years Ended December 31,		
	2003	2002	2001
		(amounts in thousands)	
Segment Operating Income:			
North America	$283,045	$179,667	$ 57,501
International	78,193	435	(102,503)
Consolidated	$361,238	$180,102	$ (45,002)
Year-over-year improvement:			
North America	58%	212%	
International	17,875	N/A	
Consolidated	101	N/A	
Segment Operating Margin:			
North America	9%	7%	2%
International	4	0	(15)
Consolidated	7	5	(1)

The key drivers in the year-over-year improvement in segment operating income are revenue growth and efficiencies in our fulfillment process. Revenue growth was driven, in part, by lowering prices, including increased adoption by our customers of our free shipping offers. Operating expenses in our North America and International segments increased $22 million and $61 million, or 4% and 24% in 2003 in comparison to the prior year. The increases in segment operating expenses were primarily related to variable costs, including fulfillment-related costs for picking, packaging, and shipping our products to customers, and credit card fees, offset by reductions in most other expense categories. Segment operating expenses represented 18% and 16% of net sales for North America and International segments, compared with 20% and 21% in the prior year. The year-over-year

declines in segment operating expenses as a percentage of net sales result from leveraging the fixed cost portion of our operations over increased volume. See "Net Sales and Gross Profit" below for additional information about increases in our sales volume.

In 2002, improvements in our income (loss) from operations over the prior year were also significantly affected by the decline in amortization charges, primarily relating to the required adoption of SFAS No. 142, *Goodwill and Other Intangible Assets*, and lower restructuring-related charges.

Net Sales and Gross Profit

Net sales information is as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Net Sales			
North America			
Media	$2,269,472	$1,994,949	$1,810,175
Electronics and other general merchandise	878,519	681,041	577,524
Other	110,422	85,467	72,637
Total North America	3,258,413	2,761,457	2,460,336
International			
Media	1,779,476	1,103,665	645,453
Electronics and other general merchandise	224,606	65,877	16,134
Other	1,204	1,937	510
Total International	2,005,286	1,171,479	662,097
Consolidated			
Media	4,048,948	3,098,614	2,455,628
Electronics and other general merchandise	1,103,125	746,918	593,658
Other	111,626	87,404	73,147
Total consolidated	$5,263,699	$3,932,936	$3,122,433
Net Sales Growth Rate			
North America			
Media	14%	10%	
Electronics and other general merchandise	29	18	
Other	29	18	
Total North America	18	12	
International			
Media	61	71	
Electronics and other general merchandise	241	308	
Other	(38)	280	
Total International	71	77	
Consolidated			
Media	31	26	
Electronics and other general merchandise	48	26	
Other	28	19	
Total Consolidated	34	26	
Consolidated Revenue Mix			
Media	77%	79%	79%
Electronics and other general merchandise	21	19	19
Other	2	2	2
Total Consolidated	100%	100%	100%

Revenue growth is due to increased demand, which was driven by increased selection, lower prices, including from our free shipping offers, and improved features and services available on our websites, including

our Amazon Marketplace and Merchant@ programs. Revenues improved $232 million and $47 million in 2003 and 2002 in comparison to the preceding years due to changes in foreign exchange rates as the U.S. Dollar weakened. The future growth of our International segment, measured in U.S. Dollars, may fluctuate significantly with changes in foreign exchange rates. See Item 1 of Part I, "Business—Additional Factors That May Affect Future Results—We Have Foreign Exchange Risk." We also anticipate that, as the revenue base of our International segment increases, the percentage growth rates in local currency will likely decline over time.

Sales of products by third-party sellers on our websites continue to increase. Since revenues from these sales are recorded as a net amount, they result in lower revenues but higher gross margins per unit, as there are no associated costs classified within cost of sales, unless we perform fulfillment services. To the extent product sales by third-party sellers continue to increase, we anticipate improvement in gross margin, offset to the extent we offer additional or broader price reductions, free shipping offers, and other promotions.

Gross profit is as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Gross Profit			
North America	$ 866,664	$740,985	$657,229
International	390,504	251,633	141,329
Consolidated	$1,257,168	$992,618	$798,558
Gross Profit Growth Rate			
North America	17%	13%	
International	55	78	
Consolidated	27	24	
Gross Margin			
North America	27%	27%	27%
International	19	21	21
Consolidated	24	25	26

The increases in gross profit in comparison with the prior years corresponds with increased revenue, offset by our year-round free shipping offers and lower prices for customers. Generally, our gross margins fluctuate based on several factors, including our mix of sales during the year, sales volumes by third-party sellers, competitive pricing decisions, changes in vendor pricing, and general efforts to reduce prices for our customers over time, as well as the extent to which our customers accept our free shipping offers. These free shipping offers reduce shipping revenue as a percentage of sales and reduce our gross margins on retail sales. In particular, we commenced offering free super saver delivery in the U.K. in 2003, and this decision decreased the gross margins for our International segment. We view our shipping offers as an effective marketing tool and intend to continue offering them. Gross profit in 2003 benefited $46 million in comparison to 2002 due to changes in foreign exchange rates as the U.S. Dollar weakened.

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

	Years Ended December 31,		
	2003	2002	2001
Supplemental Information			
Shipping Activity			
Shipping revenue	$ 372,000	$364,749	$357,325
Net shipping cost	(136,468)	(39,554)	(19,163)

We believe that offering low prices to our customers is fundamental to our future success. One way we offer lower prices is through free-shipping alternatives that result in a net cost to us in delivering products. We seek to

offset these costs over time through achieving higher sales volumes and better operating efficiencies and by negotiating better terms with our suppliers.

Fulfillment

Fulfillment costs were $477 million, $392 million, and $374 million for 2003, 2002, and 2001, representing 9%, 10%, and 12% of net sales. The increase in fulfillment costs in comparison with the prior year primarily relates to variable costs corresponding with sales volume and our mix of product sales. The mix of product sales affects fulfillment costs per shipment based on variations in shape and weight of our products. The improvement in fulfillment costs as a percentage of net sales results from improvements in productivity and accuracy, the increase in units fulfilled, which leverages the fixed-cost portion of our fulfillment network, efficiencies gained through utilization of fulfillment services provided by third parties, a decline in customer service contacts per order resulting from improvements in our operations, and enhancements to our customer self-service features available on our websites. These improvements were offset, in part, by credit card fees associated with third-party seller transactions, which represent a significant percentage relative to commission amounts earned, and as a result negatively affect fulfillment as a percentage of net sales.

Marketing

Marketing expenses, net of co-operative marketing reimbursements, were $123 million, $125 million, and $138 million for 2003, 2002, and 2001, representing 2%, 3%, and 4% of net sales. Although we do not expect them to do so, if co-operative marketing reimbursements decline in future periods, we may incur additional expenses to continue certain promotions or elect to reduce or discontinue them.

We direct customers to our websites primarily through a number of online marketing channels, including our Syndicated Stores and Associates programs, which enable associated websites to make our products available to their audiences with fulfillment performed by us. Under these arrangements, we pay a sales commission on product sales, which is classified as "Marketing" on our consolidated statements of operations.

Declines in expense for marketing-related activities reflect management efforts to cut ineffective marketing programs, as well as reduced rates charged to us for some online marketing activities. These decreases are partially offset by increased investment in marketing channels considered most effective in driving incremental net sales, such as targeted online advertising through various Web portals and our Associates program. We expect absolute dollars spent in marketing to increase in 2004.

Technology and Content

Technology and content expenses were $208 million, $216 million, and $241 million for 2003, 2002, and 2001, representing 4%, 5%, and 8% of net sales. The decline in absolute dollars spent for 2003 primarily reflects improved expense management and general price reductions in most expense categories, offset by increases in employee-related costs. The decline in absolute dollars spent for 2002 primarily reflects our migration to a technology platform that utilizes a less-costly technology infrastructure. We expect absolute dollars spent in technology and content to increase during 2004 as we continue to hire more computer scientists and software engineers, however as a percentage of net sales, we expect these costs to remain flat or possibly decline.

General and Administrative

General and administrative expenses were $88 million, $79 million, and $90 million for 2003, 2002, and 2001, representing 2% of net sales for 2003 and 2002, and 3% of net sales for 2001. We generally expect administrative costs to increase over time commensurate with the increasing size and complexity of our business. In 2004, we expect ongoing general and administrative costs to increase in absolute terms, however as a percentage of net sales, we expect these costs to remain flat or possibly decline.

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Stock-Based Compensation

Stock-based compensation was $88 million, $69 million, and $5 million for 2003, 2002, and 2001. In late 2002, we began issuing restricted stock units as our primary form of stock-based compensation. Previously, we primarily issued at-the-money stock options. In certain of our foreign jurisdictions, we continue to grant stock options.

At December 31, 2003, we had 30 million stock awards outstanding, including 25 million stock options, which had a weighted average exercise price of $12.46; 4 million restricted stock units; and 1 million shares of restricted stock. Common shares outstanding, which includes restricted stock, plus shares underlying stock options and restricted stock units, totaled 433 million at December 31, 2003, flat with the prior year. For additional information about our stock-based compensation and awards, see Item 8 of Part II, "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies," and "—Note 8—Stockholders' Deficit."

Amortization of Goodwill and Other Intangibles

Amortization of goodwill and other intangibles was $3 million, $5 million, and $181 million for 2003, 2002, and 2001. Goodwill is no longer amortized, in accordance with GAAP, and based on the current balance of intangibles, absent any additional investment, amortization of intangibles will not be significant going forward.

Restructuring-Related and Other

Cash payments resulting from our January 2001 operational restructuring were $26 million and $45 million for 2003 and 2002. Based on currently available information, we estimate the remaining restructuring-related cash outflows will be as follows (in thousands):

	Leases	Other	Total
Years Ending December 31,			
2004	$ 9,577	$ 897	$ 10,474
2005	4,998	300	5,298
2006	3,421	—	3,421
2007	3,356	—	3,356
2008	2,691	—	2,691
Thereafter	5,300	—	5,300
Total estimated cash outflows (1)	$ 29,343	$ 1,197	$ 30,540

(1) Cash flows are presented net of an estimated $39 million in sublease rentals. At December 31, 2003 we have signed sublease agreements totaling $15 million.

For additional information about our January 2001 operational restructuring, see Item 8 of Part II, "Financial Statements and Supplementary Data—Note 10—Restructuring-Related and Other."

Net Interest Expense

We generally invest our excess cash in A-rated or higher short-to-intermediate-term fixed income securities and money market mutual funds. Our interest income corresponds with the average balance of invested funds and the prevailing rates we are earning on them. The primary components of our interest expense relate to our debt instruments. During 2003, we redeemed our 10% Senior Discount Notes and we redeemed a portion of our 4.75% Convertible Subordinated Notes. At December 31, 2003, our total long-term indebtedness was $1.95 billion. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 6—Long-Term Debt and Other" and "—Note 17—Subsequent Events."

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Other Income (Expense), Net

Other income (expense), net was a gain of $3 million and $6 million for 2003 and 2002, and a loss of $2 million in 2001. These amounts consist of gains on sales of marketable securities; state, foreign, and other taxes; and miscellaneous non-operating gains and losses. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 11—Other Income (Expense), Net" for additional information.

Remeasurement of 6.875% PEACS and Other

Remeasurement of 6.875% PEACS and other consisted of the following (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Foreign-currency gain (loss) on 6.875% PEACS (1)	$(140,130)	$(103,136)	$ 46,613
Loss on redemption of long-term debt (2)	(23,829)	—	—
Foreign currency effect on intercompany balances (3)	35,574	—	—
Other-than-temporary impairments and other (4)	(1,276)	6,863	(48,754)
Total remeasurement of 6.875% PEACS and other	$(129,661)	$ (96,273)	$ (2,141)

(1) Each period the remeasurement of our 6.875% PEACS from Euros to U.S. Dollars results in gains or losses recorded to "Remeasurement of 6.875% PEACS and other" on our consolidated statements of operations.

(2) See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 6—Long-Term Debt and Other" for additional information on repayments of long-term debt in 2003.

(3) Represents the gain associated with the remeasurement of intercompany balances due to changes in foreign exchange rates (See Item 8 of Part II "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies—Foreign Currencies"). In future periods, remeasurement of intercompany balances that remain outstanding will result in gains or losses being recorded to "Remeasurement of 6.875% PEACS and other" on our consolidated statements of operations.

(4) Includes a $6 million loss relating to the termination of our Euro Currency Swap in 2003. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 6—Long-Term Debt and Other" for additional information on the termination of our Euro Currency Swap. As a result of this termination, any fluctuations in the Euro to U.S. Dollar exchange will have a greater effect on our interest expense.

Income Taxes

Subject to certain limitations, we have approximately $2.9 billion of net operating loss carryforwards that begin to expire at various times starting in 2010. Approximately $1.6 billion of our net operating loss carryforwards relates to tax deductible stock-based compensation in excess of amounts recognized for financial reporting purposes. To the extent that net operating loss carryforwards, if realized, relate to stock-based compensation, the resulting tax benefits will be recorded to stockholders' equity, rather than to results of operations. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 13—Income Taxes" for additional information.

Net Income (Loss)

Although we reported net income for the year ended 2003, we believe that this net income result should not be viewed as a material positive event and is not necessarily predictive of future reported results for a variety of reasons. For example, had we not changed our intent as to the settlement of the intercompany balances during the fourth quarter, we would have had a small net loss for the year and our net income for the fourth quarter would have been reduced by almost 50%. Additionally, we are unable to forecast the effect on our future reported results of certain items, including the stock-based compensation associated with variable accounting treatment and the gain or loss associated with the remeasurement of our 6.875% PEACS and intercompany balances that results from fluctuations in foreign exchange rates. These items represented significant quarterly charges and gains during 2003 and may result in significant charges or gains in future periods.

Unearned Revenue

Unearned revenue was $38 million and $48 million at December 31, 2003 and 2002. Unearned revenue represents payments received by us in advance of our service obligations. As we continue to structure our agreements to align the timing of our cash receipts with the service provided, we expect that, over time, balances of unearned revenue may continue to decline. We believe this trend in unearned revenue is not significant relative to the trend in our cash flows or operating results. See "Net Sales and Gross Profit" above.

Non-GAAP Financial Measures

Regulation G, "Conditions for Use of Non-GAAP Financial Measures," and other provisions of the Securities Exchange Act of 1934 ("1934 Act") define and prescribe the conditions for use of certain non-GAAP financial information. We believe that certain of our financial measures which meet the definition of a non-GAAP financial measure are important supplemental information to investors. We provide: "consolidated segment operating income (loss)," "pro forma net income (loss)," "pro forma net earnings (loss) per share," and "free cash flow."

We use these non-GAAP financial measures for internal managerial purposes, when publicly providing guidance on possible future results, and as a means to evaluate period-to-period comparisons. These non-GAAP financial measures are used in addition to and in conjunction with results presented in accordance with GAAP. These non-GAAP financial measures should not be relied upon to the exclusion of GAAP financial measures. These non-GAAP financial measures reflect an additional way of viewing aspects of our operations that, when viewed with our GAAP results and the accompanying reconciliations to corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting our business. Management strongly encourages investors to review our financial statements and publicly-filed reports in their entirety and to not rely on any single financial measure.

Because non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. For example, certain companies disclose a financial measure of earnings before certain charges such as interest, taxes, depreciation, and amortization, commonly referred to as EBITDA. We considered the use of EBITDA as a supplemental performance measure to GAAP, but believe consolidated segment operating income (loss) and pro forma net income (loss) are superior for our Company as certain periodic costs associated with our invested capital, such as fixed asset depreciation expense and amortization of software development costs, and certain costs associated with our capital structure, such as interest expense, are relevant and important factors affecting our management decisions. For information about our financial results as reported in accordance with GAAP, see Item 8 of Part II, "Financial Statements and Supplementary Data." For a quantitative reconciliation of our non-GAAP financial measures to the most comparable GAAP financial measures, see "Reconciliation Tables" below.

Consolidated Segment Operating Income (Loss)

We measure operating results of our segments using an internal performance measure of direct segment operating expenses that excludes:

- Stock-based compensation;
- Amortization of other intangibles; and
- Restructuring-related and other.

These operating expense line items are not allocated to segment results, and all other centrally-incurred operating costs are fully allocated to segment results. The sum of our individual segment results is consolidated segment operating income (loss), which we reconcile to GAAP operating income (loss). Pursuant to SEC staff interpretations of Regulation G, when presented in our financial statement footnotes, consolidated segment

operating income is a GAAP financial measure; however, since we also present this financial measure outside the context of our financial statement footnotes, we have included this financial measure in our discussion of non-GAAP financial measures.

We use consolidated segment operating income (loss), and ratios based on it, to manage and evaluate our business operations and overall financial performance. Our management evaluates consolidated segment income (loss) because it excludes certain cash and non-cash items that are either beyond our immediate control or that we believe are not characteristic of our underlying business operations for the period in which they are recorded, or both.

Items Excluded From Consolidated Segment Operating Income (Loss)

Stock-Based Compensation

We exclude stock-based compensation for the following reasons:

- Stock-based compensation expense is excluded from our internal operating plans and measurement of financial performance, although we consider the dilutive impact to our investors when awarding stock-based compensation and value such awards accordingly;
- Stock-based compensation charges or gains are non-cash; and
- The measurement of stock-based compensation is determined under a variety of methods depending on the underlying award. These methods include: (a) fixed accounting on stock options granted at market prices, resulting in no compensation expense, (b) variable accounting on certain stock options and restricted stock units, resulting in unpredictable charges or gains beyond our control, and (c) fixed accounting for certain restricted stock units, resulting in the estimated fair value of the award recognized over the service period.

We record the employer portion of payroll tax expense, a cash expense, resulting from exercises of stock-based awards in "Fulfillment," "Marketing," "Technology and content," and "General and administrative" on our consolidated statements of operations and do not include such expenses in "Stock-based compensation."

Amortization of Other Intangibles

We exclude "Amortization of other intangibles" for the following reasons:

- Amortization of other intangibles is excluded from our internal operating plans and measurement of financial performance;
- Amortization of other intangibles is a non-cash charge to current operations; and
- Amortization of other intangibles has diminished, is currently immaterial, and is scheduled to fully amortize by the end of 2004.

Restructuring-Related and Other

We exclude restructuring-related and other expenses, which are cash and non-cash amounts, for the following reasons:

- We have implemented only one restructuring event in our history, which we announced in January 2001, and accordingly we believe internally that this line item is not as important to understanding our quarterly trends as other line items;
- Since we do not regularly have restructuring-related charges, the exclusion of such charges from prior periods provides better comparability of our results of operations as viewed by management; and
- Our restructuring-related and other charges have diminished, and except for periodic adjustments to our estimates that may be required from time to time, we do not currently expect to record additional restructuring-related charges in the foreseeable future.

Impairment of Goodwill

If, in the future, we incur impairment losses on our goodwill, such charges would be excluded from consolidated segment operating income (loss) since they would be non-cash, and not in the immediate control of management. We have elected to perform our annual analysis during the fourth calendar quarter of each year. No indicators of impairment were identified during the year ended December 31, 2003.

Limitations of Consolidated Segment Operating Income (Loss)

Consolidated segment operating income (loss) has certain limitations. First, because it excludes "Stock-based compensation," the financial measure does not include all expenses primarily related to our workforce. We compensate for this limitation by providing supplemental information about stock-based compensation on the face of our consolidated statements of operations and in the footnotes to our financial statements. We also provide supplemental information about outstanding stock-based awards, including their dilutive effect on shareholders, in the footnotes to our financial statements. See Item 8 of Part II "Financial Statements and Supplementary Data—Note 1—Description of Business and Accounting Policies" for presentation of our stock-based compensation expense calculated on a consistent basis for all awards using the fair value method as prescribed under SFAS No. 123, *Accounting for Stock-Based Compensation*, as well as total outstanding stock-based awards and related activity.

Second, consolidated segment operating income (loss) excludes "Restructuring-related and other." For companies that periodically undergo restructuring events, excluding such costs from performance measures could provide an incomplete summary of ongoing costs that would affect future cash flows. However, we compensate for this limitation by disclosing cash flow measures, including operating cash flow, that incorporate all ongoing cash obligations associated with our January 2001 restructuring event and by providing disclosure of future estimated cash flows and remaining commitments associated with this event. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 6—Restructuring-Related and Other." There can be no assurance that we will not undertake another restructuring event in the future that would affect future cash flows. If we have a restructuring event in the future, we will re-evaluate our decision to exclude such charges from our consolidated segment operating income (loss) based on those future facts and circumstances at that time.

Pro Forma Net Income (Loss)

Pro forma net income (loss), including the related pro forma net earnings (loss) per share, which we reconcile to net income (loss) and net earnings (loss) per share, excludes, in addition to the line items described above as excluded from consolidated segment operating income (loss), the following line items on our consolidated statements of operations:

- Remeasurement of 6.875% PEACS and other;
- Equity in losses of equity-method investees, net; and
- Cumulative effect of change in accounting principle.

We use pro forma net income (loss), and ratios based on it, to manage and evaluate our business operations and overall financial performance. Our decision to use this financial measure is due to the fact that pro forma net income (loss) excludes certain cash and non-cash items that are either beyond our immediate control or are not characteristic of our underlying business operations for the period in which they are recorded, or both.

Items Excluded From Pro Forma Net Income (Loss)

See "Consolidated Segment Operating Income (Loss)—Items Excluded from Consolidated Segment Operating Income (Loss)" for an explanation of "Stock-based compensation," "Amortization of other intangibles," "Restructuring-related and other," and "Impairment of goodwill."

Remeasurement of 6.875% PEACS and Other

The majority of "Remeasurement of 6.875% PEACS and other" consists of gains or charges due to our quarterly remeasurement of the principal of our 6.875% PEACS from Euros to U.S. Dollars. We exclude the effect of these periodic remeasurements from our pro forma net income (loss) because the ultimate cash effect resulting from changes in exchange rates is inherently uncertain. These gains or charges would only affect near-term cash flows if we redeem or, in certain cases, restructure, our 6.875% PEACS in the next several years, rather than over a longer term or at maturity in 2010. Because these charges and gains vary based on exchange rates between the U.S. Dollar and Euro, these amounts are beyond our immediate control and are difficult to predict for future periods.

Additionally, we exclude gains or charges associated with remeasurements of foreign-currency denominated intercompany balances. We exclude these amounts because they are beyond our immediate control and are difficult to predict for future periods.

This line item also includes $24 million of losses associated with the redemption of our 10% Senior Discount Notes and a portion of our 4.75% Convertible Subordinated Notes and $6 million of losses associated with the termination of our Euro Currency Swap.

Equity in Losses of Equity-Method Investees, Net

We exclude equity in losses of equity-method investees, net, because it generates potential non-cash gains or losses, which are based on the financial results of other companies that we do not manage or control and are difficult to predict. In addition, we believe these non-cash gains and losses are not indicative of our financial or operating performance. Finally, in recent quarters, these amounts represented insignificant charges and, absent future investments, we expect this trend to continue.

Cumulative Effect of Change in Accounting Principle

We exclude cumulative effect of change in accounting principle because it generates non-cash charges, which we believe are not indicative of our financial or operating performance.

Limitations of Pro Forma Net Income (Loss)

Pro forma net income (loss) has the same limitations as consolidated segment operating income. See "Consolidated Segment Operating Income (Loss)—Limitations of Consolidated Segment Operating Income (Loss)" above. In addition, when the 6.875% PEACS are retired, whether by early redemption or restructuring, or at maturity in 2010, the foreign currency effect of changes in the exchange ratio between the U.S. Dollar and the Euro will result in a cash effect. We compensate for this limitation by disclosing the effect of currency movements on our 6.875% PEACS on our consolidated statements of operations and presenting the fair value of our 6.875% PEACS in the notes to our financial statements. See Item 8 of Part II, "Financial Statements and Supplementary Data—Note 6—Long-Term Debt and Other."

Free Cash Flow

Free cash flow, which we reconcile to "Net cash provided by (used in) 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 where 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.

Limitations of Free Cash Flow

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. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows.

Full year and corresponding quarterly consolidated segment operating income, and certain cash flow information for 2003, 2002 and 2001, were as follows (in thousands):

	Year Ended December 31, 2003				
	Full Year	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Consolidated segment operating income	$ 361,238	$ 152,936	$ 73,653	$ 67,189	$ 67,460
Pro forma net income	$ 256,022	$ 124,979	$ 48,427	$ 42,268	$ 40,348
Consolidated segment operating income as a percentage of net sales	7%	8%	6%	6%	6%
Pro forma basic earnings per share	$ 0.65	$ 0.31	$ 0.12	$ 0.11	$ 0.10
Pro forma diluted earnings per share	$ 0.61	$ 0.29	$ 0.11	$ 0.10	$ 0.10
Weighted average shares used in computation of pro forma basic earnings per share	395,479	401,422	397,912	393,876	388,541
Weighted average shares used in computation of pro forma diluted earnings per share	419,352	425,214	422,802	418,138	411,091
Net cash provided by (used in) operating activities	$ 392,022	$ 480,963	$ 36,817	$ 126,024	$(251,782)
Net cash provided by (used in) investing activities	236,651	93,489	(60,012)	233,668	(30,494)
Net cash provided by (used in) financing activities	(331,986)	(177,242)	37,798	(227,876)	35,334

	Year Ended December 31, 2002				
	Full Year	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Consolidated segment operating income	$ 180,102	$ 101,958	$ 27,492	$ 25,994	$ 24,658
Pro forma net income (loss)	$ 66,487	$ 75,382	$ 353	$ (4,409)	$ (4,839)
Consolidated segment operating income as a percentage of net sales	5%	7%	3%	3%	3%
Pro forma basic earnings (loss) per share	$ 0.18	$ 0.20	$ 0.00	$ (0.01)	$ (0.01)
Pro forma diluted earnings (loss) per share	$ 0.17	$ 0.19	$ 0.00	$ (0.01)	$ (0.01)
Weighted average used in computation of pro forma basic earnings (loss) per share	378,363	383,702	379,650	376,937	373,031
Weighted average shares used in computation of pro forma diluted earnings (loss) per share	399,656	407,056	398,361	376,937	373,031
Net cash provided by (used in) operating activities	$ 174,291	$ 372,579	$ 38,108	$ 4,637	$(241,033)
Net cash provided by (used in) investing activities	(121,684)	(36,279)	11,082	(93,981)	(2,506)
Net cash provided by financing activities	106,894	62,702	1,912	39,434	2,846

	Year Ended December 31, 2001				
	Full Year	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Consolidated segment operating income (loss)	$ (45,002)	$ 58,680	$ (27,072)	$ (28,009)	$ (48,601)
Pro forma net income (loss)	$(157,031)	$ 34,785	$ (58,005)	$ (57,528)	$ (76,283)
Consolidated segment operating income (loss) as a percentage of net sales	(1)%	5%	(4)%	(4)%	(7)%
Pro forma basic earnings (loss) per share	$ (0.43)	$ 0.09	$ (0.16)	$ (0.16)	$ (0.21)
Pro forma diluted earnings (loss) per share	$ (0.43)	$ 0.09	$ (0.16)	$ (0.16)	$ (0.21)
Weighted average shares used in computation of pro forma basic earnings (loss) per share	364,211	371,420	368,052	359,752	357,424
Weighted average shares used in computation of pro forma diluted earnings (loss) per share	364,211	384,045	368,052	359,752	357,424
Net cash provided by (used in) operating activities	$(119,782)	$ 349,120	$ (64,403)	$ 2,485	$(406,984)
Net cash provided by (used in) investing activities	(253,294)	(232,630)	(95,018)	29,803	44,551
Net cash provided by (used in) financing activities	106,881	(2,393)	94,466	3,550	11,258

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The following is a reconciliation of our non-GAAP measures to the most comparable GAAP measures for 2003, 2002, and 2001. Quarterly reconciliations are consistent with full-year presentation.

	Year Ended December 31, 2003			Year Ended December 31, 2002			Year Ended December 31, 2001		
	As Reported (1)	Adjustments	Pro Forma	As Reported (1)	Adjustments	Pro Forma	As Reported (1)	Adjustments	Pro Forma
		(in thousands)			(in thousands)			(in thousands)	
Net sales	$5,263,699	$ —	$5,263,699	$3,932,936	$ —	$3,932,936	$3,122,433	$ —	$3,122,433
Cost of sales	4,006,531	—	4,006,531	2,940,318	—	2,940,318	2,323,875	—	2,323,875
Gross profit	1,257,168	—	1,257,168	992,618	—	992,618	798,558	—	798,558
Operating expenses:									
Fulfillment	477,032	—	477,032	392,467	—	392,467	374,250	—	374,250
Marketing	122,787	—	122,787	125,383	—	125,383	138,283	—	138,283
Technology and content	207,809	—	207,809	215,617	—	215,617	241,165	—	241,165
General and administrative	88,302	—	88,302	79,049	—	79,049	89,862	—	89,862
Stock-based compensation	87,751	(87,751)	—	68,927	(68,927)	—	4,637	(4,637)	—
Amortization of goodwill and other intangibles	2,752	(2,752)	—	5,478	(5,478)	—	181,033	(181,033)	—
Restructuring-related and other	140	(140)	—	41,573	(41,573)	—	181,585	(181,585)	—
Total operating expenses	986,573	(90,643)	895,930	928,494	(115,978)	812,516	1,210,815	(367,255)	843,560
Income (loss) from operations	270,595	90,643	361,238(2)	64,124	115,978	180,102(2)	(412,257)	367,255	(45,002)(2)
Interest income	21,955	—	21,955	23,687	—	23,687	29,103	—	29,103
Interest expense	(129,979)	—	(129,979)	(142,925)	—	(142,925)	(139,232)	—	(139,232)
Other income (expense), net	2,808	—	2,808	5,623	—	5,623	(1,900)	—	(1,900)
Remeasurement of 6.875% PEACS and other	(129,661)	129,661	—	(96,273)	96,273	—	(2,141)	2,141	—
Total non-operating expenses, net	(234,877)	129,661	(105,216)	(209,888)	96,273	(113,615)	(114,170)	2,141	(112,029)
Income (loss) before equity in losses of equity-method investees	35,718	220,304	256,022	(145,764)	212,251	66,487	(526,427)	369,396	(157,031)
Equity in losses of equity-method investees, Net	(436)	436	—	(4,169)	4,169	—	(30,327)	30,327	—
Income (loss) before change in accounting principle	35,282	220,740	256,022	(149,933)	216,420	66,487	(556,754)	399,723	(157,031)
Cumulative effect of change in accounting principle	—	—	—	801	(801)	—	(10,523)	10,523	—
Net income (loss)	$ 35,282	$ 220,740	$ 256,022	$ (149,132)	$ 215,619	$ 66,487	$ (567,277)	$ 410,246	$ (157,031)

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	Year Ended December 31, 2003			Year Ended December 31, 2002			Year Ended December 31, 2001		
	As Reported(1)	Adjustments	Pro Forma	As Reported(1)	Adjustments	Pro Forma	As Reported(1)	Adjustments	Pro Forma
		(in thousands)			(in thousands)			(in thousands)	
Basic earnings (loss) per share:									
Prior to cumulative effect of change in accounting principle	$ 0.09	$ 0.56	$ 0.65	$ (0.40)	$ 0.58	$ 0.18	$ (1.53)	$ 1.10	$ (0.43)
Cumulative effect of change in accounting principle	—	—	—	0.01	(0.01)	—	(0.03)	0.03	—
	$ 0.09	$ 0.56	$ 0.65	$ (0.39)	$ 0.57	$ 0.18	$ (1.56)	$ 1.13	$ (0.43)
Diluted earnings (loss) per share:									
Prior to cumulative effect of change in accounting principle	$ 0.08	$ 0.53	$ 0.61	$ (0.40)	$ 0.57	$ 0.17	$ (1.53)	$ 1.10	$ (0.43)
Cumulative effect of change in accounting principle	—	—	—	0.01	(0.01)	—	(0.03)	0.03	—
	$ 0.08	$ 0.53	$ 0.61	$ (0.39)	$ 0.56	$ 0.17	$ (1.56)	$ 1.13	$ (0.43)
Weighted average shares used in computation of earnings (loss) per share:									
Basic	395,479		395,479	378,363		378,363	364,211		364,211
Diluted	419,352		419,352	378,363		399,656	364,211		364,211
Net cash provided by (used in) operating activities			$ 392,022			$ 174,291			$(119,782)
Purchases of fixed assets, including internal-use software and Website development			(45,963)			(39,163)			(50,321)
Free cash flow			$ 346,059			$ 135,128			$(170,103)
Net cash provided by (used in) investing activities			$ 236,651			$(121,684)			$(253,294)
Net cash provided by (used in) financing activities			$(331,986)			$ 106,894			$ 106,881

(1) In accordance with accounting principles generally accepted in the United States.
(2) Consolidated segment operating income.

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Guidance

First quarter of 2004 net sales are expected to be between $1.39 billion and $1.49 billion, or grow between 28% and 38%. For the full year 2004, net sales are expected to be between $6.20 billion and $6.70 billion. However, any such projections are subject to substantial uncertainty. See Item 1 of Part I, "Business—Additional Factors That May Affect Future Results."

Assuming among other things, and solely for purposes of this estimate, that we do not record any revisions to our restructuring-related estimates and that the closing price of our common stock on March 31, 2004 and December 31, 2004 is identical to the closing price of $52.62 on December 31, 2003, operating income for the first quarter of 2004 is expected to be between $80 million and $100 million, and, for the full year of 2004, to be between $355 million and $455 million. However, any such projections are subject to substantial uncertainty. See Item 1 of Part I, " Business—Additional Factors That May Affect Future Results." In addition, our GAAP operating projections are based on an assumption about our future stock price performance, which is required to estimate stock-based compensation and is difficult to accurately predict.

First quarter of 2004 consolidated segment operating income is expected to be between $95 million and $115 million. For the full year 2004, consolidated segment operating income is expected to be between $430 million and $530 million. However, any such projections are subject to substantial uncertainty. See Item 1 of Part I, "Business—Additional Factors That May Affect Future Results."

Item 7A. ***Quantitative and Qualitative Disclosure 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 disclosure about market risk is set forth below and in Item 7 of Part II, "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 balance sheets. We generally invest our excess cash in A-rated or higher short- to intermediate-term fixed income securities and 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.

The following table provides information about our cash equivalent and marketable fixed income securities, including principal cash flows by expected maturity and the related weighted average interest rates at December 31, 2003. Amounts were as follows (in thousands, except percentages):

	2004	2005	2006	2007	2008	Thereafter	Total	Estimated Fair Value at December 31, 2003
Commercial paper and short-term obligations	$675,061	$ —	$ —	$ —	$—	$ —	$675,061	$ 675,061
Weighted average interest rate	2.00%	—	—	—	—	—	2.00%	
Certificates of deposit	27,395	—	—	—	—	—	27,395	27,395
Weighted average interest rate	2.00%	—	—	—	—	—	2.00%	
Corporate notes and bonds	11,280	2,000	8,520	2,330	—	—	24,130	24,997
Weighted average interest rate	1.34%	1.51%	1.96%	1.96%	—	—	1.68%	
Asset-backed and agency securities	20,700	18,875	30,370	14,440	—	—	84,385	85,692
Weighted average interest rate	1.22%	1.88%	2.03%	2.32%	—	—	1.83%	
Treasury notes and bonds	4,000	6,751	95,770	37,600	—	—	144,121	145,778
Weighted average interest rate	1.12%	1.59%	1.50%	2.12%	—	—	1.96%	
Cash equivalents and marketable fixed-income securities	$738,436	$27,626	$134,660	$54,370	$—	$	$955,092	$ 958,923

The following table provides information about our cash equivalent and marketable fixed income securities, including principal cash flows by expected maturity and the related weighted average interest rates at December 31, 2002. Amounts are as follows (in thousands, except percentages):

	2003	2004	2005	2006	2007	Thereafter	Total	Estimated Fair Value at December 31, 2002
Commercial paper and short-term obligations	$437,363	$ —	$ —	$ —	$—	$ —	$437,363	$ 437,363
Weighted average interest rate	2.10%	—	—	—	—	—	2.10%	
Certificates of deposit	22,326	—	—	—	—	—	22,326	22,326
Weighted average interest rate	3.16%	—	—	—	—	—	3.16%	
Corporate notes and bonds	2,745	26,618	13,493	—	—	—	42,856	42,941
Weighted average interest rate	2.06%	1.75%	2.24%	—	—	—	1.93%	
Asset-backed and agency securities	20,572	175,330	115,605	—	—	4,953	316,460	316,715
Weighted average interest rate	2.09%	1.48%	2.13%	—	—	6.71%	1.89%	
Treasury notes and bonds	9,320	105,385	37,831	22,142	—	—	174,678	174,726
Weighted average interest rate	1.42%	1.48%	1.91%	2.10%	—	—	1.62%	
Cash equivalents and marketable fixed-income securities	$492,326	$307,333	$166,929	$22,142	$—	$ 4,953	$993,683	$ 994,071

At December 31, 2003, we have long-term debt of $1.95 billion primarily associated with our 6.875% PEACS and 4.75% Convertible Subordinated Notes, which are due in 2010 and 2009. Our payment commitments associated with these debt instruments are fixed during the corresponding terms and are comprised of periodic interest payments and principal payments at maturity. The market value of our long-term debt will fluctuate with movements of interest rates, 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 6.875% PEACS was $870 million and $531 million at December 31, 2003 and 2002, and the fair value of the 4.75% Convertible Subordinated Notes was $1.06 billion (principal balance of $1.05 billion) and $925 million (principal balance of $1.25 billion) at December 31, 2003 and 2002.

Foreign Exchange Risk

During 2003, net sales from our International segment (consisting of *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr*, and *www.amazon.co.jp*) accounted for 38% of our consolidated revenues. Net sales and related expenses generated from these websites, as well as those relating to *www.amazon.ca*, are denominated in the functional currencies of the corresponding websites, and include Euros, British Pounds, Yen, and Canadian Dollars. 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 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 transaction gains or losses on the remeasurement of intercompany balances. As a result of fluctuations in foreign exchange rates during 2003, International segment revenues improved $226 million and our operating results improved $15 million in comparison with the prior year.

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 December 31, 2003 of $764 million, an assumed 5%, 10%, and 20% negative currency movement would result in fair value declines of $38 million, $76 million, and $153 million. All investments are classified as "available for sale," as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*

We have foreign exchange risk related to our 6.875% PEACS, which have an outstanding principal balance of 690 million Euros ($870 million, based on the exchange rate as of December 31, 2003). Based on the outstanding 6.875% PEACS's principal balance, an assumed 5%, 10%, and 20% weakening of the U.S. Dollar in relation to the Euro would result in losses of approximately $43 million, $87 million, and $174 million, recorded to "Remeasurement of 6.875% PEACS and other." We are not hedged on interest payments under our 6.875% PEACS. Assuming the U.S. Dollar weakens against the Euro by 5%, 10%, and 15% in 2004, we would incur $2 million, $4 million, and $6 million additional interest expense due solely to fluctuations in foreign exchange.

Investment Risk

As of December 31, 2003, our recorded basis in equity securities was $23 million, including $9 million classified as "Marketable securities" and $15 million classified as "Other equity investments." We regularly review the carrying value of our investments and identify and record losses when events and circumstances indicate that such declines in the fair value of such assets below our accounting basis are other-than-temporary. During 2003, we recorded impairment losses totaling $2 million, compared to $8 million during the year ended December 31, 2002, to write-down several of our equity securities to fair value. The fair values of our investments are subject to significant fluctuations due to volatility of the stock market and changes in general economic conditions. Based on the fair value of the publicly-traded equity securities we held at December 31, 2003 of $86 million (recorded basis of $16 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 $13 million, $26 million and $43 million.

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Item 8. ***Financial Statements and Supplementary Data***

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REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Amazon.com, Inc.

We have audited the accompanying consolidated balance sheets of Amazon.com, Inc. as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' deficit and cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedule listed at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Amazon.com, Inc. at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the full provisions of Statement of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002. The Company also adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, effective January 1, 2001. In addition, as discussed in Note 1 to the consolidated financial statements, effective January 1, 2002, the Company prospectively changed its inventory costing method to the first-in first-out method of accounting.

/s/ Ernst & Young LLP

Seattle, Washington
January 23, 2004,
except for the last two paragraphs of Note 6 and Note 17,
as to which the date is January 27, 2004

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AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31,		
	2003	2002	2001
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 738,254	$ 540,282	$ 822,435
OPERATING ACTIVITIES:			
Net income (loss)	35,282	(149,132)	(567,277)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation of fixed assets, including website development costs, and other amortization	75,558	82,274	84,709
Stock-based compensation	87,751	68,927	4,637
Equity in losses of equity-method investees, net	436	4,169	30,327
Amortization of goodwill and other intangibles	2,752	5,478	181,033
Non-cash restructuring-related and other	—	3,470	73,293
Gain on sale of marketable securities, net	(9,598)	(5,700)	(1,335)
Remeasurement of 6.875% PEACS and other (See Note 12)	129,661	96,273	2,141
Non-cash interest expense and other	12,918	29,586	26,629
Cumulative effect of change in accounting principle	—	(801)	10,523
Changes in operating assets and liabilities:			
Inventories	(76,786)	(51,303)	30,628
Accounts receivable, net and other current assets	305	(32,948)	20,732
Accounts payable	167,732	156,542	(44,438)
Accrued expenses and other current liabilities	(25,740)	4,491	50,031
Additions to unearned revenue	101,641	95,404	114,738
Amortization of previously unearned revenue	(111,740)	(135,466)	(135,808)
Interest payable	1,850	3,027	(345)
Net cash provided by (used in) operating activities	392,022	174,291	(119,782)
INVESTING ACTIVITIES:			
Sales and maturities of marketable securities and other investments	813,184	553,289	370,377
Purchases of marketable securities	(535,642)	(635,810)	(567,152)
Purchases of fixed assets, including internal-use software and website development	(45,963)	(39,163)	(50,321)
Proceeds from sale of subsidiary and other	5,072	—	—
Investments in equity-method investees and other investments	—	—	(6,198)
Net cash provided by (used in) investing activities	236,651	(121,684)	(253,294)
FINANCING ACTIVITIES:			
Proceeds from exercise of stock options and other	163,322	121,689	16,625
Proceeds from issuance of common stock, net of issuance costs	—	—	99,831
Proceeds from long-term debt and other	—	—	10,000
Repayment of long-term debt, capital lease obligations, and other	(495,308)	(14,795)	(19,575)
Net cash provided by (used in) financing activities	(331,986)	106,894	106,881
Foreign-currency effect on cash and cash equivalents	67,332	38,471	(15,958)
Net increase (decrease) in cash and cash equivalents	364,019	197,972	(282,153)
CASH AND CASH EQUIVALENTS, END OF PERIOD	$1,102,273	$ 738,254	$ 540,282
SUPPLEMENTAL CASH FLOW INFORMATION:			
Fixed assets acquired under capital leases and other financing arrangements	$ 2,677	$ 3,023	$ 5,597
Stock issued in connection with minority investment	—	—	5,000
Cash paid for interest	119,947	111,589	112,184
Cash paid for income taxes	1,825	1,448	4,459

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Years Ended December 31,		
	2003	2002	2001
Net sales	$5,263,699	$3,932,936	$3,122,433
Cost of sales	4,006,531	2,940,318	2,323,875
Gross profit	1,257,168	992,618	798,558
Operating expenses:			
Fulfillment	477,032	392,467	374,250
Marketing	122,787	125,383	138,283
Technology and content	207,809	215,617	241,165
General and administrative	88,302	79,049	89,862
Stock-based compensation (1)	87,751	68,927	4,637
Amortization of goodwill and other intangibles	2,752	5,478	181,033
Restructuring-related and other	140	41,573	181,585
Total operating expenses	986,573	928,494	1,210,815
Income (loss) from operations	270,595	64,124	(412,257)
Interest income	21,955	23,687	29,103
Interest expense	(129,979)	(142,925)	(139,232)
Other income (expense), net	2,808	5,623	(1,900)
Remeasurement of 6.875% PEACS and other (See Note 12)	(129,661)	(96,273)	(2,141)
Total non-operating expenses, net	(234,877)	(209,888)	(114,170)
Income (loss) before equity in losses of equity-method investees	35,718	(145,764)	(526,427)
Equity in losses of equity-method investees, net	(436)	(4,169)	(30,327)
Income (loss) before change in accounting principle	35,282	(149,933)	(556,754)
Cumulative effect of change in accounting principle	—	801	(10,523)
Net income (loss)	$ 35,282	$ (149,132)	$ (567,277)
Basic earnings (loss) per share:			
Prior to cumulative effect of change in accounting principle	$ 0.09	$ (0.40)	$ (1.53)
Cumulative effect of change in accounting principle	—	0.01	(0.03)
	$ 0.09	$ (0.39)	$ (1.56)
Diluted earnings (loss) per share:			
Prior to cumulative effect of change in accounting principle	$ 0.08	$ (0.40)	$ (1.53)
Cumulative effect of change in accounting principle	—	0.01	(0.03)
	$ 0.08	$ (0.39)	$ (1.56)
Weighted average shares used in computation of earnings (loss) per share:			
Basic	395,479	378,363	364,211
Diluted	419,352	378,363	364,211

(1) Components of stock-based compensation:

	2003	2002	2001
Fulfillment	$ 17,960	$ 12,126	$ 481
Marketing	4,968	4,239	690
Technology and content	49,555	35,926	2,723
General and administrative	15,268	16,636	743
	$ 87,751	$ 68,927	$4,637

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	December 31, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,102,273	$ 738,254
Marketable securities	292,550	562,715
Inventories	293,917	202,425
Accounts receivable, net and other current assets	132,069	112,282
Total current assets	1,820,809	1,615,676
Fixed assets, net	224,285	239,398
Goodwill, net	69,121	70,811
Other intangibles, net	518	3,460
Other equity investments	14,831	15,442
Other assets	32,469	45,662
Total assets	$ 2,162,033	$ 1,990,449
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 819,811	$ 618,128
Accrued expenses and other current liabilities	317,730	314,935
Unearned revenue	37,844	47,916
Interest payable	73,100	71,661
Current portion of long-term debt and other	4,216	13,318
Total current liabilities	1,252,701	1,065,958
Long-term debt and other	1,945,439	2,277,305
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, $0.01 par value:		
Authorized shares—500,000		
Issued and outstanding shares—none	—	—
Common stock, $0.01 par value:		
Authorized shares—5,000,000		
Issued and outstanding shares—403,354 and 387,906 shares	4,034	3,879
Additional paid-in capital	1,899,398	1,649,946
Deferred stock-based compensation	(2,850)	(6,591)
Accumulated other comprehensive income	37,739	9,662
Accumulated deficit	(2,974,428)	(3,009,710)
Total stockholders' deficit	(1,036,107)	(1,352,814)
Total liabilities and stockholders' deficit	$ 2,162,033	$ 1,990,449

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(in thousands)

	Common Stock		Additional Paid-In Capital	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount					
Balance at December 31, 2000	357,140	$ 3,571	$ 1,338,303	$ (13,448)	$ (2,376)	$ (2,293,301)	$ (967,251)
Net loss	—	—	—	—	—	(567,277)	(567,277)
Foreign currency translation losses, net	—	—	—	—	(1,257)	—	(1,257)
Change in unrealized gain (loss) on available-for-sale securities, net	—	—	—	—	7,005	—	7,005
Net unrealized losses on Euro-based currency swap	—	—	—	—	(17,337)	—	(17,337)
Reclassification of currency gains on 6.875% PEACS	—	—	—	—	(9,811)	—	(9,811)
Cumulative effect of change in accounting principle	—	—	—	—	(12,294)	—	(12,294)
Comprehensive loss	—	—	—	—	—	—	(600,971)
Issuance of common stock, net of issuance costs	8,989	90	98,716	—	—	—	98,806
Exercise of common stock options, net	6,089	61	14,989	—	—	—	15,050
Repayments of note receivable for common stock	—	—	1,130	—	—	—	1,130
Deferred stock-based compensation and other, net of adjustments	1,000	10	9,631	(4,797)	—	—	4,844
Amortization of deferred stock-based compensation	—	—	—	8,392	—	—	8,392
Balance at December 31, 2001	373,218	3,732	1,462,769	(9,853)	(36,070)	(2,860,578)	(1,440,000)
Net loss	—	—	—	—	—	(149,132)	(149,132)
Foreign currency translation gains, net	—	—	—	—	16,910	—	16,910
Change in unrealized gain (loss) on available-for-sale securities, net	—	—	—	—	20,294	—	20,294
Net unrealized gains on Euro-based currency swap	—	—	—	—	8,528	—	8,528
Comprehensive loss	—	—	—	—	—	—	(103,400)
Exercise of common stock options, net	14,728	147	121,542	—	—	—	121,689
Deferred stock-based compensation, net of adjustments	(40)	—	1,569	(2,828)	—	—	(1,259)
Income tax benefit on stock awards	—	—	23	—	—	—	23
Amortization of deferred stock-based compensation	—	—	—	6,090	—	—	6,090
Stock compensation – restricted stock units	—	—	3,913	—	—	—	3,913
Stock compensation – variable accounting	—	—	60,130	—	—	—	60,130
Balance at December 31, 2002	387,906	3,879	1,649,946	(6,591)	9,662	(3,009,710)	(1,352,814)
Net income	—	—	—	—	—	35,282	35,282
Foreign currency translation gains, net	—	—	—	—	14,707	—	14,707
Change in unrealized gain (loss) on available-for-sale securities, net	—	—	—	—	2,482	—	2,482
Net unrealized gains on Euro-based currency swap	—	—	—	—	10,888	—	10,888
Comprehensive income	—	—	—	—	—	—	63,359
Exercise of common stock options, net and vesting of restricted stock	15,413	155	163,195	—	—	—	163,350
Notes converted	1	—	47	—	—	—	47
Income tax benefit on stock awards	—	—	2,200	—	—	—	2,200
Amortization of deferred stock-based compensation	—	—	—	3,741	—	—	3,741
Issuance of common stock – employee benefit plan	34	—	1,444	—	—	—	1,444
Stock compensation – restricted stock units	—	—	30,691	—	—	—	30,691
Stock compensation – variable accounting	—	—	51,875	—	—	—	51,875
Balance at December 31, 2003	403,354	$ 4,034	$ 1,899,398	$ (2,850)	$ 37,739	$ (2,974,428)	$ 1,036,107

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—DESCRIPTION OF BUSINESS AND ACCOUNTING POLICIES

Description of Business

Amazon.com, Inc., a Fortune 500 company, commenced operations on the World Wide Web in July 1995. We seek to offer Earth's Biggest Selection and to be Earth's most customer-centric company, where customers can find and discover anything they may want to buy online. We endeavor to offer our customers the lowest possible prices. Through our Merchants@ and Amazon Marketplace programs, we enable businesses and individuals to sell virtually anything to Amazon.com's millions of customers

We operate six global websites: *www.amazon.com, www.amazon.co.uk, www.amazon.de, www.amazon.fr, www.amazon.co.jp,* and *www.amazon.ca.* We have organized our operations into two principal segments: North America and International. The North America segment includes the operating results of *www.amazon.com* and *www.amazon.ca.* The International segment includes the operating results of *www.amazon.co.uk, www.amazon.de, www.amazon.fr,* and *www.amazon.co.jp.*

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. 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 assets and liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, inventory valuation, depreciable lives, sales returns, receivables valuation, restructuring-related liabilities, incentive discount offers, valuation of investments, taxes, and contingencies. Actual results could differ materially from those estimates.

Cash and Cash Equivalents

We classify all highly liquid instruments with an original maturity of three months or less at the time of purchase as cash equivalents.

Allowance for Doubtful Accounts

We estimate losses on receivables based on known troubled accounts, if any, and historical experience of losses incurred.

Inventories

Inventories, consisting of products available for sale, are accounted for using the 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 record a valuation allowance to adjust the carrying amount of our inventories to lower of cost or market value.

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AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Asset Retirement Obligations

In accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations,* we establish assets and liabilities for the present value of estimated future costs to return certain of our leased facilities to their original condition. Such assets are depreciated over the lease period into operating expense, and the recorded liabilities are accreted to the future value of the estimated restoration costs. Such amounts are not significant.

Accounting Changes

Inventories

Effective January 1, 2002, we prospectively changed our inventory costing method from the specific identification method to the FIFO method of accounting. This change resulted in a cumulative increase in inventory of $0.8 million, with a corresponding amount recorded to "Cumulative effect of change in accounting principle" on the consolidated statements of operations. We received a letter of preferability for this change in inventory costing from our independent auditors.

Goodwill and Other Intangibles

Effective January 1, 2002, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires that purchased goodwill and certain indefinite-lived intangibles no longer be amortized, but instead be tested for impairment at least annually. We evaluated our intangible assets and determined that all such assets have determinable lives.

In accordance with Accounting Principles Board ("APB") Opinion No. 20, *Accounting Changes*, the effect of these accounting changes is reflected prospectively. Supplemental comparative disclosure, as if the change had been retroactively applied, is as follows (in thousands, except per share data):

	For the Years Ended December 31,		
	2003	2002	2001
Net income (loss):			
Reported net income (loss)	$35,282	$(149,132)	$(567,277)
Goodwill amortization (1)	—	—	172,159
Inventory costing change	—	(801)	380
Adjusted net income (loss)	$35,282	$(149,933)	$(394,738)
Basic and diluted earnings (loss) per share:			
Reported basic earnings (loss) per share	$ 0.09	$ (0.39)	$ (1.56)
Goodwill amortization (1)	—	—	0.48
Inventory costing change	—	(0.01)	—
Adjusted basic earnings (loss) per share	$ 0.09	$ (0.40)	$ (1.08)
Adjusted diluted earnings (loss) per share	$ 0.08	$ (0.40)	$ (1.08)

(1) Includes $54 million, or $0.15 per share, for 2001, related to amortization of other intangibles that was classified as goodwill effective January 1, 2002.

Fixed Assets

Fixed assets are stated at cost less accumulated depreciation, which includes the amortization of assets recorded under capital leases. Fixed assets, including assets purchased under capital leases, are depreciated on a straight-line basis over the estimated useful lives of the assets (generally two to ten years).

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Included in fixed assets is the cost of internal-use software and website development, including software used to upgrade and enhance our websites. We expense all costs related to the development of internal-use software other than those incurred during the application development stage. Costs incurred during the application development stage are capitalized and amortized over the estimated useful life of the software, generally two years.

Goodwill

Net goodwill declined by $2 million during 2003 relating to the disposition of a subsidiary that was previously included in our North America segment.

We performed an impairment analysis in 2003 and 2002, as required by SFAS No. 142, and concluded that the carrying amount of goodwill was appropriate. During 2003 and 2002, we did not acquire any additional goodwill.

Other Intangibles

Other intangibles consist of the following (in thousands):

	December 31, 2003			December 31, 2002		
	Other Intangibles, Gross	Accumulated Amortization	Other Intangibles, Net (2)	Other Intangibles, Gross	Accumulated Amortization	Other Intangibles, Net
Contract-based (1)	$ 13,469	$ (13,469)	$ —	$ 16,584	$ (14,414)	$ 2,170
Marketing-related	5,617	(5,326)	291	5,617	(5,010)	607
Technology-based	4,386	(4,360)	26	4,386	(4,331)	55
Customer-related	2,021	(1,820)	201	2,021	(1,393)	628
Other intangibles	$ 25,493	$ (24,975)	$ 518	$ 28,608	$ (25,148)	$ 3,460

(1) Net intangibles of $190,000 were disposed of during 2003 in connection with the sale of a subsidiary.
(2) The net carrying amount of intangible assets at December 31, 2003 is scheduled to be fully amortized by the end of 2004.

Investments

The initial carrying cost of our investments is the price we paid at acquisition. Investments are accounted for using the equity method of accounting if the investment gives us the ability to exercise significant influence, but not control, over an investee. We record our investments in equity-method investees on the consolidated balance sheets as "Other equity investments" and our share of the investees' earnings or losses as "Equity in losses of equity-method investees, net" on the consolidated statements of operations.

All other equity investments, which consist of investments for which we do not have the ability to exercise significant influence, are accounted for under the cost method. Under the cost method of accounting, investments in private companies are carried at cost and are adjusted only for other-than-temporary declines in fair value, distributions of earnings, and additional investments. For public companies that have readily determinable fair values, we classify our equity investments as available-for-sale and, accordingly, record these investments at their fair values with unrealized gains and losses included in "Accumulated other comprehensive income (loss)."

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

We generally invest our excess cash in A-rated or higher short- to intermediate-term fixed income securities and money market mutual funds. Such investments are included in "Marketable securities" on the accompanying consolidated balance sheets and are reported at fair value with unrealized gains and losses included in "Accumulated other comprehensive income (loss)." The weighted average method is used to determine the cost of Euro-denominated securities sold and the specific identification method is used to determine the cost of all other securities.

We periodically evaluate whether declines in fair values of our investments are other-than-temporary. This evaluation consists of a review of qualitative and quantitative factors, including quoted market prices, if available; recent financial results and operating trends; other publicly available information; implied values from any recent financing rounds; or other conditions that bear on the value of our investments.

Long-Lived Assets

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets is not recoverable.

For long-lived assets used in operations, impairment losses are only recorded if the asset's carrying amount is not recoverable through its undiscounted, probability-weighted cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value. Long-lived assets are considered held for sale when certain criteria are met, including: management has committed to a plan to sell the asset, the asset is available for sale in its immediate condition, and the sale is probable within one year of the reporting date. Assets held for sale are reported at the lower of cost or fair value less costs to sell.

Other Assets

Other assets consist primarily of professional fees paid in connection with the issuance of our long-term debt. These fees are amortized ratably into interest expense over the life of the underlying debt.

Unearned Revenue

Unearned revenue is recorded when payments are received in advance of our service obligations and is amortized ratably over the service period.

Income Taxes

We recognize deferred tax assets and liabilities based on differences between the financial reporting basis and tax basis of assets and liabilities using the enacted tax rates and laws that are expected to be in effect when the differences are expected to be recovered. We provide a valuation allowance against our deferred tax assets to the extent such assets are not expected to be realized.

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

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

arrangements with multiple deliverables are divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: (1) the delivered item has value to the customer on a standalone basis; (2) there is objective and reliable evidence of the fair value of undelivered items; and (3) delivery of any undelivered item is probable.

We evaluate the criteria outlined in Emerging Issues Task Force ("EITF") Issue No. 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 obligor 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 the primary obligor and amounts earned are determined using a fixed percentage, a fixed-payment schedule, or a combination of the two, we generally record the net amounts as commissions earned.

Product sales, 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 a sales contract that provides 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.

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 presented as a net amount in "Net sales."

Commissions and per-unit fees received from third-party sellers and amounts earned through our Merchant.com program are recognized when the item is sold by the third-party seller and our collectibility is reasonably assured. We record an allowance for estimated refunds on such commissions using historical experience

Outbound shipping charges to customers are included in net sales and amounted to $372 million, $365 million, and $357 million in 2003, 2002, and 2001.

Cost of Sales

Cost of sales consists of the purchase price of consumer products sold by us, inbound and outbound shipping charges to us, packaging supplies, and certain costs associated with our service revenues. In instances where we incur fulfillment costs to ship products on behalf of third-party sellers or provide customer service on their behalf, such costs are classified as "Cost of sales" rather than "Fulfillment" on the consolidated statements of operations. All credit card fees and bad debt costs, including those associated with our guarantee for certain third-party seller transactions, are classified in "Fulfillment" on the consolidated statements of operations.

Outbound shipping charges and the cost of tangible supplies used to package products for shipment to customers totaled $508 million, $404 million, and $376 million in 2003, 2002, and 2001.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Fulfillment

Fulfillment costs represent those costs incurred in operating and staffing our fulfillment and customer service centers, including costs attributable to receiving, inspecting, and warehousing inventories; picking, packaging, and preparing customer orders for shipment; credit card fees and bad debt costs, including costs associated with our guarantee for certain third-party seller transactions; and responding to inquiries from customers. Fulfillment costs also include amounts paid to third-parties that assist us in fulfillment and customer service operations. Certain of our fulfillment-related costs that are incurred on behalf of other businesses, such as Toysrus.com, Inc. and Target Corporation, are classified as cost of sales rather than fulfillment.

Marketing

Marketing expenses consist of advertising; on-line marketing, including amounts paid under our Syndicated Stores and Associates programs; public relations expenditures; and payroll and related expenses for personnel engaged in marketing and selling activities. To the extent co-operative marketing reimbursements decline in future periods, we may incur additional expenses to continue certain promotions or elect to reduce or discontinue them.

Advertising and other promotional costs, which are expensed as incurred, are included in marketing expense and were $109 million, $114 million, and $125 million in 2003, 2002, and 2001. Prepaid advertising costs were not significant at December 31, 2003 and 2002.

Technology and Content

Technology and content expenses consist principally of payroll and related expenses for development, editorial, systems, and telecommunications operations personnel; systems and telecommunications infrastructure; and costs of acquired content, including freelance reviews.

Technology and content costs are expensed as incurred, except for certain costs relating to the development of internal-use software and website development, including upgrades and enhancements to our websites, which are capitalized and depreciated over two years. Fixed assets associated with capitalized internal-use software, content, and website development, net of accumulated depreciation, were $33 million and $27 million at December 31, 2003 and 2002. Costs capitalized during the application development stage for internal-use software, offset by corresponding amortization, were a net deferral of $5 million in 2003, a net expense of $1 million in 2002, and a net deferral of $3 million in 2001.

Stock-Based Compensation

We generally have three categories of stock-based awards: restricted stock units, restricted stock, and stock options. We account for stock-based awards under the intrinsic value method, which follows the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. The intrinsic value method of accounting results in compensation expense to the extent option exercise prices are set below market prices on the date of grant. Also, to the extent stock awards have been subject to an exchange offer, other modifications, or performance criteria, such awards are subject to variable accounting treatment. Variable accounting treatment results in expense or contra-expense recognition using the cumulative expense method, calculated based on quoted prices of our common stock and vesting schedules of underlying awards. To the extent stock options are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to "Stock-based compensation."

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Since October, 2002, we grant restricted stock units as our primary form of stock-based compensation; however, in certain of our foreign jurisdictions, we continue to grant stock options. Stock options granted after December 31, 2002 are subject to variable accounting treatment. Restricted stock units and restricted stock are generally measured at fair value on the date of grant based on the number of shares granted and the quoted price of our common stock. Such value is recognized as an expense over the corresponding service period using the accelerated method under FASB Interpretation ("FIN") No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.* To the extent restricted stock or restricted stock units are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to "Stock-based compensation."

We record the employer portion of payroll tax expense resulting from exercises of stock options and vesting of restricted stock in "Fulfillment," "Marketing," "Technology and content," and "General and administrative" on our consolidated statements of operations and do not include such expenses in "Stock-based compensation." Stock-based compensation includes matching contributions under our 401(k) program.

Stock-based compensation consisted of the following (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Stock awards—variable accounting	$51,875	$60,130	$ 484
Fixed accounting (1):			
Restricted stock units	30,691	3,913	—
Restricted stock (2)	5,185	4,884	4,153
Total stock-based compensation	$87,751	$68,927	$4,637

(1) Fair value of awards determined at grant date and recognized as expense over the service period.
(2) Includes expense associated with matching contributions under our 401(k) savings plan.

We granted stock awards representing 2 million, 3 million, and 46 million shares of common stock during 2003, 2002, and 2001. These awards generally vest over service periods of between three and six years.

The following table summarizes relevant information as if the fair value recognition provisions of SFAS No. 123, *Accounting for Stock Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure,* had been applied to all stock-based awards (in thousands, except per share data):

	Years Ended December 31,		
	2003	2002	2001
Net income (loss)—as reported	$ 35,282	$(149,132)	$(567,277)
Add: Stock-based compensation, as reported	87,751	68,927	4,637
Deduct: Total stock-based compensation determined under fair value based method for all awards	(94,525)	(148,083)	(400,445)
Net income (loss)—SFAS No. 123 adjusted	$ 28,508	$(228,288)	$(963,085)
Basic earnings (loss) per share—as reported	$ 0.09	$ (0.39)	$ (1.56)
Diluted earnings (loss) per share—as reported	$ 0.08	$ (0.39)	$ (1.56)
Basic and diluted earnings (loss) per share—SFAS No. 123 adjusted	$ 0.07	$ (0.60)	$ (2.64)

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The fair value for each stock option granted was estimated at the date of grant using a Black-Scholes option-pricing model, assuming no dividends and the following assumptions:

	Years Ended December 31,		
	2003	2002	2001
Average risk-free interest rate	2.5%	3.1%	4.1%
Average expected life (in years)	3.3	3.3	3.3
Volatility	77.7%	81.8%	98.0%

The per share weighted average fair value of stock awards, including restricted stock units, granted in 2003, 2002, and 2001, was $29.88, $14.99, and $5.98.

Outstanding stock awards were as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Stock options (1)(2)	24,961	42,005	65,950
Restricted stock units (3)	4,410	2,935	20
Outstanding stock awards, excluded from common stock outstanding	29,371	44,940	65,970
Restricted stock (4)	790	1,011	1,113
Total outstanding stock awards	30,161	45,951	67,083

(1) The weighted average exercise price was $12.46, $11.91, and $10.65 at December 31, 2003, 2002, and 2001.
(2) Includes 1 million, 5 million, and 12 million options at December 31, 2003, 2002, and 2001 subject to variable accounting treatment.
(3) Includes 322,000 and 330,000 restricted stock units subject to variable accounting treatment at December 31, 2003 and 2002.
(4) Included in issued and outstanding common stock.

Restructuring Estimates

Restructuring-related liabilities include estimates for, among other things, anticipated disposition of lease obligations. Key variables in determining such estimates include anticipated timing of sublease rentals, estimates of sublease rental payment amounts and tenant improvement costs, and estimates for brokerage and other related costs. Additionally, we may determine that certain of the office space previously vacated as part of our 2001 restructuring, which we have been unable to sublease due to poor real estate market conditions, may be necessary for our future expansion needs. We periodically evaluate and, if necessary, adjust our estimates based on currently-available information. If we elect to utilize this office space, in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, we will adjust our restructuring-related liability and classify future payments to "General and administrative" on the consolidated statements of operations.

Foreign Currency

We have the following internationally-focused websites: *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr*, *www.amazon.co.jp*, and *www.amazon.ca*. Net sales generated from internationally-focused websites, as well as most of the related expenses incurred from those operations, are denominated in the

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functional currencies of the resident countries. Additionally, the functional currency of our subsidiaries that either operate or support *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr*, *www.amazon.co.jp* and *www.amazon.ca* is the same as the local currency of the United Kingdom, Germany, France, Japan and Canada. Assets and liabilities of these subsidiaries are translated into U.S. Dollars at period-end exchange rates, and revenues and expenses are translated at average rates prevailing throughout the period. Translation adjustments are included in "Accumulated other comprehensive income (loss)," a separate component of stockholders' deficit and in the "Effect of exchange-rate changes on cash and cash equivalents," on the consolidated statements of cash flows. Transaction gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved are included in "Other income (expense), net" on the consolidated statements of operations. See "Note 11—Other Income (Expense), Net."

A provision of SFAS No. 52, *Foreign Currency Translation*, requires that gains and losses arising from intercompany foreign currency transactions considered long-term investments, where settlement is not planned or anticipated in the foreseeable future, be excluded in the determination of net income. Our international operations are financed, in part, by the U.S. parent company. Currency adjustments for these intercompany balances were historically recorded to equity as translation adjustments and not included in the determination of net income because we intended to permanently invest such amounts. During the fourth quarter of 2003, we made the decision that these amounts would be repaid among the entities and, accordingly, upon consolidation any exchange gain or loss arising from remeasurement of intercompany balances is required to be recorded in the determination of net income. The effect for the fourth quarter of 2003 and the year ended December 31, 2003 was to increase net income by $36 million. The effect of this treatment was very significant to our net income for the year and for the quarter. Had we not changed our intent as to the settlement of these intercompany balances, we would have had a net loss for 2003 and our net income for the fourth quarter of 2003 would have been reduced by almost 50%. See "Note 12 – Remeasurement of 6.875% PEACS and Other" for further discussion.

Derivative Financial Instruments

In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, we record derivative instruments on the consolidated balance sheets at fair value. Changes in the fair value of derivatives are recorded each period in current results of operations or other comprehensive income (loss) depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. For a derivative designated as a fair value hedge, the gain or loss of the derivative in the period of change and the offsetting loss or gain of the hedged item attributed to the hedged risk are recognized in results of operations. For a derivative designated as a cash flow hedge, the effective portion of the derivative's gain or loss is initially reported as a component of other comprehensive income (loss) and subsequently reclassified into results of operations when the hedged exposure affects results of operations. The ineffective portion of the gain or loss of a cash flow hedge is recognized currently in results of operations. For a derivative not designated as a hedging instrument, the gain or loss is recognized currently in results of operations.

We are exposed to the risk of fluctuations in foreign exchange rates between the U.S. Dollar and the Euro associated with our 6.875% PEACS (See "Note 6—Long-Term Debt and Other"). Currency gains and losses arising from the remeasurement of the 6.875% PEACS' principal from Euros to U.S. Dollars each period are recorded to "Remeasurement of 6.875% PEACS and other." During the second quarter of 2003, we terminated our Euro Currency Swap that previously was designated as a cash flow hedge of a portion of the 6.875% PEACS' principal and interest. See "Note 6—Long-Term Debt and Other."

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We hold warrants to purchase equity securities of other companies. Warrants that can be exercised and settled by delivery of net shares such that we pay no cash upon exercise are derivative financial instruments. Our net share warrants are not designated as hedging instruments; accordingly, gains or losses resulting from changes in fair value are recognized on the consolidated statements of operations, "Remeasurement of 6.875% PEACS and other," in the period of change. We determine the fair value of our warrants through option-pricing models using current market price and volatility assumptions, including public-company market comparables for our private-company warrants.

The adoption of SFAS No. 133 on January 1, 2001 resulted in cumulative transition losses of $11 million included in the results of operations and a stockholders' deficit adjustment of $12 million. Transition losses included in "Cumulative effect of change in accounting principle" are attributable to approximately $3 million in losses reclassified from "Accumulated other comprehensive income (loss)" on warrants previously reported at fair value and classified as available-for-sale, and approximately $8 million in losses on warrants previously reported at cost. No warrant investments are designated as hedging instruments. Transition losses in "Accumulated other comprehensive income (loss)" are attributable to approximately $15 million in losses on the swap agreement designated as a cash flow hedge of a portion of the 6.875% PEACS offset by the approximately $3 million in losses reclassified to results of operations on derivative instruments not designated as hedging instruments.

Earnings (Loss) Per Share

In accordance with SFAS No. 128, *Earnings Per Share*, the weighted average shares used to calculate basic earnings (loss) per share excludes the weighted average of restricted shares outstanding because they are subject to repurchase or forfeiture.

The effect of outstanding stock awards, including restricted stock, is antidilutive for periods that we have a net loss and, accordingly, is excluded from the calculation of diluted loss per share. The dilutive effect of stock awards and restricted stock is included in the calculation of weighted average shares, using the treasury stock method, for periods that we have net income.

The "if converted" number of shares associated with each of our convertible debt instruments are excluded from diluted shares as their effect is anti-dilutive. See "Note 6—Long-Term Debt and Other."

Recent Accounting Pronouncements

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities*, effective for the period ending December 31, 2003. This Interpretation requires the consolidation of Variable Interest Entities in which a company holds a qualifying variable interest. The provisions of this Interpretation do not have a significant effect on our financial position or operating results.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 establishes standards for how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after September 15, 2003. The provisions of this Standard do not have a significant effect on our financial position or operating results.

In November 2003, the EITF reached a consensus on issue 03-10, *Application of* EITF 02-16 *by Resellers to Sales Incentives Offered to Consumers by Manufacturers*, addressing how a reseller is to account for the redemption of a manufacturer's coupon by a consumer at the reseller's location. The final consensus eliminates

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the option that permitted resellers to report the value of the consideration received as a reduction in costs of goods sold, but rather mandates that it be recorded as revenue. EITF 03-10 is applicable to new arrangements, including modifications to existing arrangements, entered into in fiscal periods beginning after November 25, 2003. The provisions of this consensus do not have a significant effect on our financial position or operating results.

In November 2003, the EITF reached a consensus on issue 03-01, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. EITF 03-01 establishes additional disclosure requirements for each category of FAS 115 investments in a loss position. Effective for years ending after December 15, 2003, companies must disclose the aggregate amount of unrealized losses, and the aggregate related fair value of their investments with unrealized losses. Those investments are required to be segregated by those in a loss position for less than twelve months and those in a loss position for greater than twelve months. Additionally, certain qualitative disclosures should be made to clarify a circumstance whereby an investment's fair value that is below cost is not considered other-than-temporary. The provisions of this consensus do not have a significant effect on our financial position or operating results, and the disclosure requirements are included in "Note 2—Cash, Cash Equivalents, and Marketable Securities."

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Note 2—CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

The following tables summarize, by major security type, our cash and marketable securities (in thousands):

	December 31, 2003			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (1)	Estimated Fair Value
Cash	$ 427,306	$ —	$ —	$ 427,306
Commercial paper and short-term obligations	669,403	5,564	—	674,967
Cash and cash equivalents	1,096,709	5,564	—	1,102,273
Certificates of deposit	20,026	7,369	—	27,395
Commercial paper and short-term obligations	94		—	94
Corporate notes and bonds	24,866	131	—	24,997
Asset-backed and agency securities	85,403	302	(13)	85,692
U.S. Treasury notes and bonds	145,641	286	(149)	145,778
Equity securities	2,360	6,234	—	8,594
Marketable securities	278,390	14,322	(162)	292,550
Total cash, cash equivalents, and marketable Securities (2)	$1,375,099	$ 19,886	$ (162)	$1,394,823

(1) The fair value of investments with loss positions is $100 million. We evaluated the nature of these investments, which are primarily U.S. Treasury Notes, the duration of the impairments (all less than twelve months), and the amount of the impairments relative to the underlying portfolio and conclude that such amounts were not "other-than-temporary" as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

(2) Includes investments in foreign currencies of $764 million, principally Euros, British Pounds, and Yen.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	December 31, 2002			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash	$ 302,964	$ —	$ —	$ 302,964
Commercial paper and short-term obligations	429,943	5,347	—	435,290
Total cash and cash equivalents	732,907	5,347	—	738,254
Certificates of deposit	19,494	2,832	—	22,326
Commercial paper and short-term obligations	2,073	—	—	2,073
Corporate notes and bonds	42,586	355	—	42,941
Asset-backed and agency securities	309,549	7,166	—	316,715
U.S. Treasury notes and bonds	172,145	2,616	(35)	174,726
Equity securities	3,934	—	—	3,934
Marketable securities	549,781	12,969	(35)	562,715
Total cash, cash equivalents, and marketable Securities (1)	$ 1,282,688	$ 18,316	$ (35)	$ 1,300,969

(1) Includes investments in foreign currencies of $398 million, principally Euros, British Pounds, and Yen.

The following table summarizes contractual maturities of our cash equivalent and marketable fixed-income securities as of December 31, 2003 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	$ 704,982	$ 717,979
Due after one year through three years	155,048	155,252
Asset-backed and agency securities with various maturities	85,403	85,692
	$ 945,433	$ 958,923

Gross gains of $17 million, $9 million, and $9 million and gross losses of $1 million, $1 million and $32 million were realized on sales of available-for-sale marketable securities for the years ended December 31, 2003, 2002, and 2001.

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 and for real estate lease agreements. See "Note 7—Commitments and Contingencies."

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 3—FIXED ASSETS

Fixed assets, at cost, consist of the following (in thousands):

	December 31,	
	2003	2002
Gross Fixed Assets (1):		
Fulfillment and customer service	$ 241,497	$ 237,635
Technology infrastructure	25,592	36,037
Internal-use software, content, and website development	57,413	55,607
Other corporate assets	47,236	47,715
Gross fixed assets	371,738	376,994
Accumulated Depreciation (1):		
Fulfillment and customer service	84,987	69,208
Technology infrastructure	13,167	20,360
Internal-use software, content, and website development	24,530	28,308
Other corporate assets	24,769	19,720
Total accumulated depreciation	147,453	137,596
Total fixed assets, net	$ 224,285	$ 239,398

(1) Excludes the cost and accumulated depreciation of fully-depreciated assets.

Depreciation expense on fixed assets was $70 million, $77 million, and $83 million, which includes amortization of fixed assets acquired under capital lease obligations of $7 million for 2003 and 2002, and $9 million for 2001. Gross assets remaining under capital leases were $5 million and $39 million for the years ended December 31, 2003 and 2002. Accumulated depreciation associated with capital leases was $3 million and $15 million for the years ended December 31, 2003 and 2002.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 4—OTHER EQUITY INVESTMENTS

Activity in our equity-method and cost-method investments for the years ended December 31, 2003 and 2002 is as follows (in thousands):

	Equity-Method	Cost-Method	Total
Balance, December 31, 2001	$10,387	$ 17,972	$ 28,359
Equity-method losses, net	(4,169)	—	(4,169)
Sales of investments at fair value	(2,940)	(12,941)	(15,881)
Realized gains on sales of investments, net	2,326	10,844	13,170
Losses resulting from other-than-temporary declines in fair value	(4,288)	(794)	(5,082)
Unrealized losses on available-for-sale investments, net	—	(652)	(652)
Losses for change in fair value of warrant investments, net	—	(303)	(303)
Investment reclassifications, net, at fair value	(880)	880	—
Balance, December 31, 2002 (1)(2)	436	15,006	15,442
Equity-method losses, net	(436)	—	(436)
Sales of investments at fair value	—	(41)	(41)
Losses resulting from other-than-temporary declines in fair value	—	(2,459)	(2,459)
Unrealized gains on available-for-sale investments, net	—	1,032	1,032
Change in fair value of warrant investments, net	—	1,293	1,293
Balance, December 31, 2003 (1)(2)	$ —	$ 14,831	$ 14,831

(1) At December 31, 2003 and 2002, cost-method investments recorded in "Other equity investments" included $6 million and $5 million of investments recorded at fair value and $9 million and $10 million of investments carried at cost. Gross unrealized gains and losses were not significant at December 31, 2003 and 2002.

(2) At December 31, 2003 and 2002, the fair value of our investments in the common stock of publicly held equity-method investees was $72 million and $31 million, primarily relating to our investment in drugstore.com, inc. Currently, we do not hold over 20% interest in any of our investments.

Note 5—UNEARNED REVENUE

During 2003 and 2002, activity in unearned revenue was as follows (in thousands):

Balance, December 31, 2001	87,978
Cash received or accounts receivable	95,404
Amortization to revenue	(135,466)
Balance, December 31, 2002	47,916
Cash received or accounts receivable	101,774
Amortization to revenue	(111,846)
Balance, December 31, 2003	$ 37,844

All amounts recorded as accounts receivable, including amounts associated with unearned revenue, are legally due and contractually enforceable. At December 31, 2003 accounts receivable, net associated with unearned revenue was $2 million.

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AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 6—LONG-TERM DEBT AND OTHER

Our long-term debt and other long-term liabilities are summarized as follows (in thousands):

	December 31,	
	2003	2002
4.75% Convertible Subordinated Notes due February 2009	$1,049,760	$1,249,807
6.875% PEACS due February 2010	869,711	724,500
10% Senior Discount Notes due May 2008	—	255,597
Long-term restructuring liabilities	20,066	31,614
Euro currency swap	—	12,159
Capital lease obligations	2,717	8,491
Other long-term debt	7,401	8,456
	1,949,655	2,290,624
Less current portion of capital lease obligations	(1,558)	(7,506)
Less current portion of other long-term debt	(2,658)	(5,813)
Total long-term debt and other	$1,945,439	$2,277,305

6.875% PEACS

On February 16, 2000, we completed an offering of 690 million Euros of 6.875% PEACS due 2010. The 6.875% PEACS are convertible, at the holder's option, into our common stock at a conversion price of 84.883 Euros per share. The U.S. Dollar equivalent principal, interest, and conversion price fluctuate based on the Euro/U.S. Dollar exchange ratio. Interest on the 6.875% PEACS is payable annually in arrears in February of each year. The 6.875% PEACS are unsecured and are subordinated to any existing and future senior indebtedness. The 6.875% PEACS rank equally with our outstanding 4.75% Convertible Subordinated Notes. We have the right to redeem the 6.875% PEACS, in whole or in part, by paying the principal of 690 million Euros, plus any accrued and unpaid interest. No premium payment is required for early redemption.

Upon the occurrence of a "fundamental change" prior to the maturity of the 6.875% PEACS, each holder thereof has the right to require us to redeem all or any part of such holder's 6.875% PEACS at a price equal to 100% of the principal amount of the notes being redeemed, together with accrued interest. As defined in the indenture, a "fundamental change" is the occurrence of certain types of transactions in which our stockholders do not receive publicly-traded securities.

The indenture governing the 6.875% PEACS contains certain affirmative covenants for us, including making principal and interest payments when due, maintaining our corporate existence and properties, and paying taxes and other claims in a timely manner. We were in compliance with these covenants at December 31, 2003.

During the second quarter of 2003, we terminated our Euro Currency Swap that previously was designated as a cash flow hedge of a portion of the 6.875% PEACS' principal and interest. Although neither party made cash payments to terminate the agreement, we recorded a non-cash loss of $6 million to "Remeasurement of 6.875% PEACS and other" representing the remaining basis in our swap asset. At December 31, 2003, the remaining cumulative unrealized loss associated with our Euro Currency Swap, recorded to "Accumulated other comprehensive income," was $13 million. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, this accumulated loss will be amortized to "Remeasurement of 6.875% PEACS and other" over the life of the 6.875% PEACS. No net gains or losses resulting from hedge ineffectiveness were recognized in our results of operations during the year ended December 31, 2002 and 2001.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

If we redeem or otherwise restructure our 6.875% PEACS prior to maturity in 2010, any remaining cumulative unrealized loss associated with the Euro Currency Swap will be recorded as a charge to "Remeasurement of 6.875% PEACS and other."

Based upon quoted market prices, the fair value of the 6.875% PEACS was $870 million and $531 million as of December 31, 2003 and 2002. The fair value of the swap obligation was $12 million at December 31, 2002.

4.75% Convertible Subordinated Notes

On February 3, 1999, we completed an offering of $1.25 billion of 4.75% Convertible Subordinated Notes. 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. Interest on the 4.75% Convertible Subordinated Notes is payable semi-annually in arrears in February and August of each year. The 4.75% Convertible Subordinated Notes are unsecured and are subordinated to any existing and future Senior Indebtedness as defined in the indenture governing the 4.75% Convertible Subordinated Notes. We have the right to redeem the 4.75% Convertible Subordinated Notes, in whole or in part, by paying the principal plus a redemption premium, plus any accrued and unpaid interest. At December 31, 2003, the redemption premium was 2.85% of the principal, and decreased to 2.375% on February 1, 2004 and will decrease by 47.5 basis points annually until maturity.

Upon the occurrence of a "fundamental change" prior to the maturity of the 4.75% Convertible Subordinated Notes, each holder thereof has the right to require us to redeem all or any part of such holder's 4.75% Convertible Subordinated Notes at a price equal to 100% of the principal amount of the notes being redeemed, together with accrued interest. As defined in the indenture, a "fundamental change" is the occurrence of certain types of transactions in which our stockholders do not receive publicly-traded securities.

The indenture governing the 4.75% Convertible Subordinated Notes contains certain affirmative covenants for us, including making principal and interest payments when due, maintaining our corporate existence and properties, and paying taxes and other claims in a timely manner. We were in compliance with these covenants at December 31, 2003.

On November 24, 2003, we redeemed an aggregate principal amount of $200 million of our 4.75% Convertible Subordinated Notes. As provided in the underlying indenture, the redemption price of $206 million represented a $6 million (2.85%) premium over the face amount of the redeemed 4.75% Convertible Subordinated Notes. We recorded a charge in the fourth quarter of 2003, classified in "Remeasurement of 6.875% PEACS and other," of approximately $9 million related to the redemption, consisting of the $6 million premium and approximately $3 million in unamortized deferred issuance charges. Accrued and unpaid interest of $3 million, from August 1, 2003 through November 23, 2003, was also paid at redemption.

Based upon quoted market prices, the fair value of our 4.75% Convertible Subordinated Notes as of December 31, 2003 and 2002 was $1.06 billion (principal balance of $1.05 billion) and $925 million (principal balance of $1.25 billion).

10% Senior Discount Notes

During the second quarter of 2003, we redeemed all of our remaining 10% Senior Discount Notes for $277 million, consisting of principal repayment of $264 million and a 5% premium of $13 million. Included in our results for the year ended December 31, 2003 is a charge of $15 million to "Remeasurement of 6.875% PEACS and other" representing the 5% premium and $2 million of remaining deferred issuance charges. Additionally, we paid $2 million to holders of our 10% Senior Discount Notes for interest accrued between May 1, 2003 and

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

May 28, 2003. The interest payment of $2 million, was recorded to "Interest expense" on the consolidated statement of operations.

Subsequent Events

On January 27, 2004, we announced that we will redeem $150 million in principal amount of our outstanding 4.75% Convertible Subordinated Notes on February 26, 2004. The redemption price is set at 102.375% of the principal amount at maturity, plus accrued and unpaid interest from February 1 through February 25, 2004. After completion of the redemption of $150 million in principal, there will be approximately $900 million aggregate principal amount of 4.75% Convertible Subordinated Notes outstanding.

Additionally, on January 27, 2004, our Board of Directors authorized a debt repurchase program pursuant to which we may from time to time repurchase (through open market repurchases or private transactions), redeem or otherwise retire up to an aggregate of $500 million of our outstanding 4.75% Convertible Subordinated Notes and 6.875% PEACS.

Note 7—COMMITMENTS AND CONTINGENCIES

Commitments

We currently lease office and fulfillment center facilities and fixed assets under non-cancelable operating and capital leases. Rental expense under operating lease agreements for 2003, 2002, and 2001 was $52 million, $56 million, and $81 million.

The following summarizes our principal contractual commitments, excluding open orders for inventory purchases to support normal operations as of December 31, 2003 (in thousands):

	2004	2005	2006	2007	2008	Thereafter	Total
Restructuring-related commitments:							
Operating leases, net of estimated sublease income	$ 9,577	$ 4,998	$ 3,421	$ 3,356	$ 2,691	$ 5,300	$ 29,343
Other	897	300	—	—	—	—	1,197
Restructuring-related commitments	10,474	5,298	3,421	3,356	2,691	5,300	30,540
Other commitments:							
Debt principal and other (1)(2)	3,013	74	—	—	246	1,931,160	1,934,493
Debt interest (1)(2)	109,656	109,656	109,656	109,656	109,656	144,517	692,797
Capital leases	1,678	868	341	—	—	—	2,887
Operating leases (3)	51,498	43,323	42,391	39,100	38,181	131,040	345,533
Other commitments	165,845	153,921	152,388	148,756	148,083	2,206,717	2,975,710
Total commitments	$176,319	$159,219	$155,809	$152,112	$150,774	$2,212,017	$3,006,250

(1) The principal payment due in 2010 and the annual interest payments due under our 6.875% PEACS fluctuate based on the Euro/U.S. Dollar exchange ratio. At December 31, 2003, the Euro to U.S. Dollar exchange rate was 1.260. Due to fluctuations in the Euro/U.S. Dollar exchange ratio, our principal debt obligation under this instrument since issuance has increased by $197 million as of December 31, 2003. We cannot predict the performance of the U.S. Dollar relative to the Euro.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(2) See "Note 17—Subsequent Events."
(3) Pursuant to SFAS No. 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 No. 13 they are not reflected on the balance sheet. As of December 31, 2003, we have remaining obligations under operating leases for equipment and real estate of $346 million. If we had applied to our equipment-related operating leases the same convention used for capital leases, which, however, would not be in accordance with GAAP, we would have recorded approximately $76 million of additional assets and obligations on our balance sheet at December 31, 2003.

Restructuring-related lease obligations are as follows (in thousands):

	2004	2005	2006	2007	2008	Thereafter	Total
Gross lease obligations	$13,628	$ 9,199	$ 9,167	$ 9,196	$ 8,226	$ 18,446	$ 67,862
Estimated sublease income (1)	(4,051)	(4,201)	(5,746)	(5,840)	(5,535)	(13,146)	(38,519)
Lease obligations, net	$ 9,577	$ 4,998	$ 3,421	$ 3,356	$ 2,691	$ 5,300	$ 29,343

(1) At December 31, 2003, we had signed contractual sublease agreements covering $15 million in future payments.

Long-term capital lease obligations are as follows (in thousands):

	December 31, 2003
Gross capital lease obligations	$ 2,887
Less imputed interest	(170)
Present value of net minimum lease payments	2,717
Less current portion	(1,558)
Total long-term capital lease obligations	$ 1,159

Pledged Securities

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 and for real estate lease agreements. The amount required to be pledged for real estate lease agreements changes over the life of our leases, and with fluctuations in our market capitalization and credit-rating. The change in the total amount of collateral required to be pledged under these agreements was as follows (in thousands):

	Standby Letters of Credit (1)	Swap Agreement (2)	Real Estate Leases (3)	Total
Balance at December 31, 2002	$57,894	$ 23,095	$ 40,079	$121,068
Net change in collateral pledged	2,905	(23,095)	(14,143)	(34,333)
Balance at December 31, 2003	$60,799	$ —	$ 25,936	$ 86,735

(1) We have standby letter-of-credit facilities totaling $150 million. The outstanding commitments under these facilities at December 31, 2003 totaled $61 million.
(2) Due to the termination of the Euro Currency Swap, collateral previously pledged under this arrangement is no longer subject to restrictions.
(3) The required amount of collateral to be pledged will increase $5 million and an additional $6 million if our market capitalization is below $18 billion and $13 billion.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Legal Proceedings

A number of purported class action complaints were filed by holders of our equity and debt securities against us, our directors, and certain of our senior officers during 2001, in the United States District Court for the Western District of Washington, alleging violations of the Securities Act of 1933 (the "1933 Act") and/or the 1934 Act. On August 1, 2003, plaintiffs in the 1934 Act cases filed a second consolidated amended complaint alleging that we, together with certain of our officers and directors, made false or misleading statements during the period from October 29, 1998 through October 23, 2001 concerning our business, financial condition and results, inventories, future prospects, and strategic alliance transactions. The 1933 Act complaint alleges that the defendants made false or misleading statements in connection with our February 2000 offering of the 6.875% PEACS. The complaints seek recissionary and/or compensatory damages and injunctive relief against all defendants. We dispute the allegations of wrongdoing in these complaints and intend to vigorously defend ourselves in these matters.

On October 29, 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. We dispute the plaintiff's allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

Beginning in March 2003, we were served with complaints filed in several different states 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.

On July 17, 2003, Pinpoint, Inc. filed a complaint for patent infringement in the United States District Court for the Northern District of Illinois against us and several other companies with which we have commercial agreements. The complaint alleges that our personalization technology infringes several patents obtained by Pinpoint and seeks injunctive relief, monetary damages in an amount no less than a reasonable royalty, prejudgment interest, and attorneys' fees against all defendants. We dispute the allegations of wrongdoing in this complaint and intend to vigorously defend ourselves in this matter.

On January 12, 2004, Soverain Software LLC filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges that our website technology infringes several patents obtained by Soverain purporting to cover "Internet Server Access Control and Monitoring Systems" (U.S. Patent No. 5,708,780) and "Network Sales Systems" (U.S. Patent Nos. 5,715,314 and 5,909,492) and seeks 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 this complaint and intend to vigorously defend ourselves in this matter.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Inventory Suppliers

During 2003, no vendor accounted for 10% or more of our inventory purchases. 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.

Note 8—STOCKHOLDERS' DEFICIT

Preferred Stock

We have authorized 500,000,000 shares of $0.01 par value Preferred Stock. No preferred stock shares were outstanding during 2003, 2002, or 2001.

Stock Award Plans

Our stock award plans consist of the 1999 Nonofficer Employee Stock Option Plan, the 1997 Stock Incentive Plan, and the Amended and Restated 1994 Stock Option Plan. Shares reserved under these plans consist of 40 million shares in the 1999 Nonofficer Employee Stock Option Plan, 124 million shares in the 1997 Stock Incentive Plan and 58 million shares in the 1994 Stock Option Plan, of which up to a maximum of 21,025,075 shares that are not issued under that plan may be added to the aggregate number of shares available for issuance under the 1997 Stock Incentive Plan. In connection with certain acquisitions in 1998 and 1999, we assumed outstanding options to purchase common stock originally granted under the acquired companies' stock option plans. Our stock award plans as well as the assumed stock award plans are hereby collectively referred to as the "Plans."

In 2002, we transitioned to using restricted stock units, awarded under the 1997 Stock Incentive Plan, as our primary vehicle for employee equity compensation. Employees vest in restricted stock unit awards ratably over the corresponding service term, generally three to six years. As it relates to stock option awards, our Board of Directors generally sets an exercise price of not less than the fair market value of our common stock at the date of grant. Generally, outstanding options granted on or subsequent to December 20, 1996 have a term of 10 years from the date of grant. Subject to Internal Revenue Service limitations, options granted under our plans prior to April 1999 and granted under certain assumed plans generally became exercisable immediately, but are subject to a restriction on transfer that lapses over a period of time. Options granted under the Plans since April 1999 generally vest and become exercisable in accordance with the following vesting schedule: 20% after year one, 20% after year two and 5% at the end of each quarter for years three through five. Certain outstanding options that were granted during 2000 and 2001 vest and become exercisable at the rate of 50% after year one and 50% after year two. During the first quarter of 2001, we offered a limited non-compulsory exchange of employee stock options to employees meeting certain eligibility criteria. Options granted pursuant to this stock option exchange vested and became exercisable at the rate of 25% after 6 months from the date of grant and 4.166% per month for the succeeding 18 months. Certain options granted in the third quarter of 2001 generally vest and become exercisable as follows: (i) the option vests quarterly in equal installments over a 36, 48 or 60 month period commencing on dates ranging from grant date to October 1, 2003, (ii) the option vests 5% to 12.5% on a date approximately 12 to 16 months from date of grant with the balance vesting quarterly in equal installments over a 48 to 60 month period, or (iii) the option vests 4% to 12.5% on dates approximately 6 months and 18 months from the date of grant with the balance vesting quarterly in equal installments over a 24 or 60 month period. Shares issued upon exercise of options that are unvested are restricted and subject to repurchase by us at the exercise price upon termination of employment or services and such restrictions lapse over the vesting schedule. At December 31, 2003, approximately 800,000 shares of restricted common stock, which includes

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

restricted shares issued in connection with acquisitions as well as shares issued to certain key employees in 2001 and 2002, were subject to repurchase or forfeiture.

Stock Award Activity

During 2003, restricted stock units increased 1.5 million shares, resulting from grants of 2.1 million, offset by vesting of 0.4 million shares and cancellation of 0.3 million shares. Scheduled vesting for outstanding restricted stock units is as follows (in thousands):

	2004	2005	2006	2007	2008	Thereafter	Total
Outstanding restricted stock units	726	1,102	1,353	737	292	200	4,410

The following table summarizes our stock option activity:

	Number of Shares (In thousands)	Weighted Average Exercise Price
Balance December 31, 2000	70,438	32.17
Options granted	46,209	9.53
Options terminated	(44,608)	43.91
Options exercised	(6,089)	2.73
Balance December 31, 2001	65,950	10.65
Options granted	3,045	16.46
Options terminated	(12,262)	10.36
Options exercised	(14,728)	8.26
Balance December 31, 2002	42,005	11.91
Options granted	226	24.81
Options terminated	(2,248)	13.82
Options exercised	(15,022)	10.88
Balance December 31, 2003	24,961	12.46

At December 31, 2003, 99 million shares of common stock were available for future grant under the Plans.

The following table summarizes information about stock options outstanding at December 31, 2003:

	Stock Awards Outstanding			Awards Vested	
Range of Exercise Prices	Number of Awards (In thousands)	Remaining Life (yrs)	Weighted Average Exercise Price	Number of Awards (In thousands)	Weighted Average Exercise Price
0.08 – 7.05	1,843	3.97	4.08	1,503	3.92
7.10 – 7.93	15,400	7.60	7.90	2,139	7.82
7.95 – 12.19	1,697	7.34	9.29	200	9.92
12.28 – 17.58	1,842	7.32	15.01	583	14.76
17.67 – 21.33	2,037	6.78	19.41	999	20.01
21.33 – 30.88	901	6.70	27.41	396	27.24
31.41 – 70.44	622	6.18	46.23	420	48.62
71.28 – 87.28	565	5.25	71.93	157	73.24
88.06 – 104.97	54	5.08	88.78	51	88.74
0.08 – 104.97	24,961	7.10	12.46	6,448	15.57

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Comprehensive Income (Loss)

The changes in the components of comprehensive income (loss) were as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Net income (loss)	$ 35,282	$(149,132)	$(567,277)
Other comprehensive income (loss):			
Foreign-currency translation gains (losses), net	14,707	16,910	(1,257)
Net unrealized gains on available-for-sale securities:			
Unrealized gains (losses) arising during year	17,434	23,459	(33,479)
Less reclassification of net realized (gains) losses included in net income (loss)	(14,952)	(3,165)	40,484
Net unrealized gains on available-for-sale securities	2,482	20,294	7,005
Net activity of Euro currency swap (See Note 6):			
Remeasurement of Euro currency swap to fair value	14,842	21,106	(21,867)
Reclassification of (gains) losses to offset currency losses and gains on hedged portion of 6.875% PEACS included in net income (loss)	(5,081)	(12,578)	4,530
Amortization of net unrealized losses on Euro Currency Swap	1,127	—	—
Net activity of Euro currency swap	10,888	8,528	(17,337)
Reclassification of currency gains on 6.875% PEACS	—	—	(9,811)
Cumulative effect of accounting change to adopt SFAS No. 133	—	—	(12,294)
Other comprehensive income (loss)	28,077	45,732	(33,694)
Comprehensive income (loss)	$ 63,359	$(103,400)	$(600,971)

Accumulated balances within other comprehensive income were as follows (in thousands):

	Years Ended December 31,	
	2003	2002
Net unrealized gains on foreign currency translation	$ 30,450	$ 15,744
Net unrealized gains on available-for-sale securities	20,327	17,845
Net unrealized losses on Euro currency swap	(13,038)	(23,927)
Total accumulated other comprehensive income	37,739	9,662

Common Stock Reserved for Future Issuance

At December 31, 2003, common stock reserved for future issuance is as follows (in thousands):

Stock awards, including restricted stock units	128,223
Shares issuable upon conversion of 4.75% Convertible Subordinated Notes (1)	13,457
Shares issuable upon conversion of 6.875% PEACS	8,129
Total common stock reserved for future issuance	149,809

(1) See "Note 17—Subsequent Events."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 9—EARNINGS (LOSS) PER SHARE

The following represents the calculations for net earnings (loss) per share (in thousands, except per share data):

	For the Years Ended December 31,		
	2003	2002	2001
Income (loss) before change in accounting principle	$ 35,282	$(149,933)	$(556,754)
Cumulative effect of change in accounting principle	—	801	(10,523)
Net income (loss)	$ 35,282	$(149,132)	$(567,277)
Weighted average shares outstanding	396,389	379,494	365,180
Weighted average shares of restricted stock	(910)	(1,131)	(969)
Shares used in computation of basic earnings (loss) per share	395,479	378,363	364,211
Total dilutive effect of outstanding stock awards (1)	23,873	—	—
Shares used in computation of diluted earnings (loss) per share	419,352	378,363	364,211
Basic earnings (loss) per share:			
Prior to cumulative effect of change in accounting principle	$ 0.09	$ (0.40)	$ (1.53)
Cumulative effect of change in accounting principle	—	0.01	(0.03)
Total earnings (loss) per share	$ 0.09	$ (0.39)	$ (1.56)
Diluted earnings (loss) per share:			
Prior to cumulative effect of change in accounting principle	$ 0.08	$ (0.40)	$ (1.53)
Cumulative effect of change in accounting principle	—	0.01	(0.03)
Total earnings (loss) per share	$ 0.08	$ (0.39)	$ (1.56)

(1) The effect of outstanding stock awards, including restricted stock, is antidilutive for periods that we have a net loss and, accordingly, is excluded from the calculation of diluted loss per share in those periods. The dilutive effect of stock awards and restricted stock is included in the calculation of weighted average shares, using the treasury stock method, for periods that we have net income.

Note 10—RESTRUCTURING-RELATED AND OTHER

In the first quarter of 2001, we announced and began implementation of our operational restructuring plan to reduce operating costs, streamline our organizational structure, consolidate certain of our fulfillment and customer service operations and migrate a large portion of our technology infrastructure to a new operating platform. This initiative involved the reduction of employee staff by 1,327 positions throughout the Company in managerial, professional, clerical, technical and fulfillment roles; consolidation of our Seattle, Washington corporate office locations; closure of our McDonough, Georgia and Seattle, Washington fulfillment centers; closure of our customer service centers in Seattle, Washington and The Hague, Netherlands; and migration of a large portion of our technology infrastructure to a new operating platform, which entails ongoing lease obligations for technology infrastructure no longer being utilized. Actual employee termination benefits paid were $12 million. The restructuring is complete; however we may adjust our restructuring-related estimates in the future, if necessary.

Restructuring-related expenses of $0.1 million were incurred during the year ended December 31, 2003 relating to updated estimates of sub-lease income due to weakness in real estate markets. Restructuring-related and other expenses were $42 million and $182 million for 2002 and 2001.

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AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Restructuring-related charges were as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Asset impairments	$—	$ 1,182	$ 68,528
Continuing lease obligations	140	39,563	87,049
Termination benefits	—	—	14,970
Broker commissions, professional fees, and other miscellaneous restructuring costs	—	828	11,038
Total restructuring-related charges	$140	$41,573	$181,585

At December 31, 2003, the accrued liability associated with restructuring-related and other charges was $31 million and consisted of the following (in thousands):

	Balance at December 31, 2002	Subsequent Accruals, Net	Payments	Balance at December 31, 2003	Due Within 12 Months (1)	Due After 12 Months (1)
Lease obligations, net of estimated sublease income	$ 51,216	$ 4,092	$(25,965)	$ 29,343	$ 9,577	$ 19,766
Broker commissions, professional fees and other miscellaneous restructuring costs	5,625	(3,952)	(476)	1,197	897	300
	$ 56,841	$ 140	$(26,441)	$ 30,540	$ 10,474	$ 20,066

(1) Restructuring-related liabilities due within 12 months and due after 12 months are classified in "Accrued expenses and other current liabilities" and "Long-term debt and other," on the accompanying consolidated balance sheets.

Restructuring-related lease obligations are as follows (in thousands):

	2004	2005	2006	2007	2008	Thereafter	Total
Gross lease obligations	$13,628	$ 9,199	$ 9,167	$ 9,196	$ 8,226	$ 18,446	$ 67,862
Estimated sublease income (1)	(4,051)	(4,201)	(5,746)	(5,840)	(5,535)	(13,146)	(38,519)
Lease obligations, net	$ 9,577	$ 4,998	$ 3,421	$ 3,356	$ 2,691	$ 5,300	$ 29,343

(1) At December 31, 2003, we had signed contractual sublease agreements covering $15 million in future payments.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 11—OTHER INCOME (EXPENSE), NET

Other income (expense), net consisted of the following (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Gains on sales of marketable securities, net	$ 9,598	$ 5,700	$ 1,335
Foreign-currency transaction losses, net (1)	(3,045)	(1,086)	(2,019)
Miscellaneous state, foreign and other taxes	(3,704)	700	(1,222)
Other miscellaneous gains (losses), net	(41)	309	6
Total other income (expense), net	$ 2,808	$ 5,623	$(1,900)

(1) Includes a loss of $5 million and $2 million for 2003 and 2002, and a gain of $0.2 million for 2001 associated with the remeasurement from Euros to U.S. Dollars of interest obligations on our 6.875% PEACS. See "Note 6—Long-Term Debt and Other."

Note 12—REMEASUREMENT OF 6.875% PEACS AND OTHER

Remeasurement of 6.875% PEACS and other consisted of the following (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Foreign-currency gain (loss) on 6.875% PEACS	$(140,130)	$(103,136)	$ 46,613
Gain (loss) on sales of Euro-denominated investments, net	5,827	2,227	(22,548)
Gain on sales of equity investments, net	796	13,044	—
Gain from terminations of commercial contracts	—	—	22,400
Net gain from acquisition of investments by third parties	—	—	784
Loss on redemption of long-term debt (See Note 6)	(23,829)	—	—
Loss on termination of Euro Currency Swap (See Note 6)	(5,880)	—	—
Amortization of net unrealized losses on Euro Currency Swap (See Note 6)	(1,127)	—	—
Foreign currency effect on intercompany balances (1)	35,574	—	—
Other-than-temporary impairments and other (2)	(892)	(8,408)	(49,390)
Total remeasurement of 6.875% PEACS and other	$(129,661)	$ (96,273)	$ (2,141)

(1) Represents the gain associated with the remeasurement of intercompany balances due to changes in foreign exchange rates (See "Note 1—Description of Business and Accounting Policies").

(2) Includes a $2 million gain on the sale of our mail-order toy catalog business for $5 million in cash recorded in the third quarter of 2003.

Note 13—INCOME TAXES

We have provided for current and deferred U.S. federal, state, and foreign income taxes for the current and all prior periods presented. Current and deferred income taxes were provided with respect to jurisdictions where our subsidiaries produce taxable income. As of December 31, 2003, we have recorded a net deferred tax asset of $2 million, which consists primarily of certain state jurisdiction net operating loss carryforwards. We have provided a valuation allowance for the remainder of our deferred tax asset, consisting primarily of net operating loss carryforwards, because of uncertainty regarding its realization. The increase in the valuation allowance on the deferred tax asset was $131 million and $196 million for 2003 and 2002.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our net deferred tax assets, which are included in "Accounts receivable, net and other current assets," are as follows (in thousands):

	December 31,	
	2003	2002
Deferred tax assets:		
Net operating losses	$ 897,665	$ 792,014
Investment-related	343,296	308,403
Revenue items	24,904	22,124
Expense items	234,310	246,147
Total gross deferred tax assets	1,500,175	1,368,688
Less valuation allowance	(1,495,908)	(1,365,386)
Net deferred tax assets	4,267	3,302
Deferred tax liabilities—Expense items	(2,512)	(620)
Total net deferred tax asset	$ 1,755	$ 2,682

At December 31, 2003, we had net operating loss carryforwards of approximately $2.9 billion related to U.S. federal, state and foreign jurisdictions. Utilization of net operating losses, which begin to expire at various times starting in 2010, may be subject to certain limitations under Sections 382 and 1502 of the Internal Revenue Code of 1986, as amended, and other limitations under state and foreign tax laws. Additionally, approximately $230 million of capital loss carryforwards begin to expire in 2005. Approximately $1.6 billion of our net operating loss carryforwards relates to tax deductible stock-based compensation in excess of amounts recognized for financial reporting purposes. To the extent that net operating loss carryforwards, if realized, relate to stock-based compensation, the resulting tax benefits will be recorded to stockholders' equity, rather than to results of operations.

Note 14—EMPLOYEE BENEFIT PLAN

We have a 401(k) savings plan covering substantially all of our U.S. employees, and eligible employees may contribute through payroll deductions. Beginning in April 2003, we began matching a portion of employee contributions using our common stock. During the year ended December 31, 2003, we issued 34,000 shares of our common stock in connection with matching contributions for the 401(k) savings plan.

Note 15—SEGMENT INFORMATION

We present segment information along the same lines that our chief operating decision maker reviews our operating results in assessing performance and allocating resources. During the first quarter of 2003, our chief operating decision maker began reviewing operating results along two lines: North America and International. This change was prompted by the increasing prominence and overall importance of third-party sellers on our websites, as well as how both capital and human resources are allocated for technology and fulfillment operations.

We measure operating results of our segments using an internal performance measure of direct segment operating expenses that exclude stock-based compensation, amortization of other intangibles, and restructuring-related and other charges, each of which is not allocated to segment results. All other centrally-incurred operating costs are fully allocated to segment results. There are no internal revenue transactions between our reporting segments.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

North America

The North America segment consists of amounts earned from retail sales of consumer products through *www.amazon.com* and *www.amazon.ca* (including from third-party sellers), from North America focused Syndicated Stores and mail-order catalogs, and from non-retail activities such as North America focused Merchant.com, marketing, and promotional agreements.

International

The International segment consists of amounts earned from retail sales of consumer products through internationally focused websites, such as *www.amazon.co.uk, www.amazon.de, www.amazon.fr*, and *www.amazon.co.jp* (including from third-party sellers), from internationally focused Syndicated Stores and from non-retail activities such as internationally focused marketing and promotional agreements. This segment includes export sales from *www.amazon.co.uk, www.amazon.de, www.amazon.fr*, and *www.amazon.co.jp* (including export sales from these sites to customers in the U.S. and Canada), but excludes export sales from *www.amazon.com* and *www.amazon.ca*.

Information on reportable segments and reconciliation to consolidated net income (loss) is as follows (in thousands):

Year Ended 2003:

	North America	International	Consolidated
Net sales	$ 3,258,413	$ 2,005,286	$5,263,699
Gross profit	866,664	390,504	1,257,168
Segment operating income	283,045	78,193	361,238
Stock-based compensation			(87,751)
Amortization of other intangibles			(2,752)
Restructuring-related and other			(140)
Total non-operating expenses, net			(234,877)
Equity in losses of equity-method investees, net			(436)
Net income			$ 35,282

Year Ended 2002:

	North America	International	Consolidated
Net sales	$ 2,761,457	$ 1,171,479	$3,932,936
Gross profit	740,985	251,633	992,618
Segment operating income	179,667	435	180,102
Stock-based compensation			(68,927)
Amortization of other intangibles			(5,478)
Restructuring-related and other			(41,573)
Total non-operating expenses, net			(209,888)
Equity in losses of equity-method investees, net			(4,169)
Cumulative effect of change in accounting principle			801
Net loss			$ (149,132)

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Year Ended 2001:

	North America	International	Consolidated
Net sales	$ 2,460,336	$ 662,097	$3,122,433
Gross profit	657,229	141,329	798,558
Segment operating income (loss)	57,501	(102,503)	(45,002)
Stock-based compensation			(4,637)
Amortization of goodwill and other intangibles			(181,033)
Restructuring-related and other			(181,585)
Total non-operating expenses, net			(114,170)
Equity in losses of equity-method investees, net			(30,327)
Cumulative effect of change in accounting principle			(10,523)
Net loss			$ (567,277)

Net sales shipped to customers outside of the U.S. represented approximately 43%, 35%, and 29% of net sales for 2003, 2002, and 2001. Shipments into the United Kingdom represents approximately 13% and 11% of total net sales in 2003 and 2002, and shipments into Germany represents 11% of total net sales in 2003. Net fixed assets held in locations outside the U.S. were $45 million at December 31, 2003.

Depreciation expense, by segment, was as follows (in thousands):

	North America	International	Consolidated
2003	$ 59,558	$ 10,186	$ 69,744
2002	67,036	9,625	76,661
2001	72,007	11,426	83,433

Note 16—FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amount and estimated fair values of our financial instruments were as follows (in thousands):

	December 31, 2003		December 31, 2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 1,099,143	$ 1,102,273	$ 732,907	$ 738,254
Marketable securities (1)	278,390	292,550	549,781	562,715
Other equity investments (2)	14,831	86,517	15,442	46,454
Euro currency swap (3)	—	—	12,159	12,159
Long-term debt (4)	1,919,471	1,924,995	2,229,904	1,719,108

(1) The fair value of marketable securities is determined from publicly quoted prices. See "Note 2—Cash, Cash Equivalents and Marketable Securities."
(2) The fair value of other equity investments is determined from publicly quoted prices, plus the carrying amount of privately-held investments for which market values are not readily determinable. We evaluate "Other equity investments" for impairment in accordance with our stated policy. See "Note 1—Description of Business and Accounting Policies," and "Note 4—Other Equity Investments."
(3) The fair value of the Euro currency swap was determined based on a third-party valuation. See "Note 6—Long-Term Debt and Other.".
(4) The fair value of our long-term debt is determined based on quoted prices. See "Note 6—Long-Term Debt and Other."

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 17—SUBSEQUENT EVENTS

On January 27, 2004, we announced that we will redeem $150 million in principal amount of our outstanding 4.75% Convertible Subordinated Notes on February 26, 2004. The redemption price is set at 102.375% of the principal amount at maturity, plus accrued and unpaid interest from February 1 through February 25, 2004. After completion of the redemption of $150 million in principal, there will be approximately $900 million aggregate principal amount of 4.75% Convertible Subordinated Notes outstanding.

Additionally, on January 27, 2004, our Board of Directors authorized a debt repurchase program pursuant to which we may from time to time repurchase (through open market repurchases or private transactions), redeem or otherwise retire up to an aggregate of $500 million of our outstanding 4.75% Convertible Subordinated Notes and 6.875% PEACS.

AMAZON.COM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 18—QUARTERLY RESULTS (UNAUDITED)

The following tables contain selected unaudited statement of operations information for each quarter of 2003, 2002, and 2001. The following information reflects all normal recurring adjustments necessary for a fair presentation of the information for the periods presented. The operating results for any quarter are not necessarily indicative of results for any future period. Unaudited quarterly results were as follows (in thousands, except per share data):

	Year Ended December 31, 2003			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$ 1,945,772	$1,134,456	$1,099,912	$1,083,559
Gross profit	426,837	285,821	273,928	270,582
Net income (loss)	73,154	15,563	(43,314)	(10,121)
Basic earnings (loss) per share (1)	$ 0.18	$ 0.04	$ (0.11)	$ (0.03)
Diluted earnings (loss) per share (1)	$ 0.17	$ 0.04	$ (0.11)	$ (0.03)
Shares used in computation of earnings (loss) per share:				
Basic	401,422	397,912	393,876	388,541
Diluted	425,214	422,802	393,876	388,541

	Year Ended December 31, 2002			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$ 1,428,610	$ 851,299	$ 805,605	$ 847,422
Gross profit	335,159	216,167	218,167	223,125
Income (loss) before change in accounting principle	2,651	(35,080)	(93,553)	(23,951)
Cumulative effect of change in accounting principle	—	—	—	801
Net income (loss)	2,651	(35,080)	(93,553)	(23,150)
Basic and diluted earnings (loss) per share (1):				
Prior to cumulative effect of change in accounting principle	$ 0.01	$ (0.09)	$ (0.25)	$ (0.06)
Cumulative effect of change in accounting principle	—	—	—	—
	$ 0.01	$ (0.09)	$ (0.25)	$ (0.06)
Shares used in computation of earnings (loss) per share:				
Basic	383,702	379,650	376,937	373,031
Diluted	407,056	379,650	376,937	373,031

	Year Ended December 31, 2001			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$ 1,115,171	$ 639,281	$ 667,625	$ 700,356
Gross profit	274,049	162,192	179,720	182,597
Income (loss) before change in accounting principle	5,087	(169,874)	(168,359)	(223,608)
Cumulative effect of change in accounting principle	—	—	—	(10,523)
Net income (loss)	5,087	(169,874)	(168,359)	(234,131)
Basic and diluted earnings (loss) per share (1):				
Prior to cumulative effect of change in accounting principle	$ 0.01	$ (0.46)	$ (0.47)	$ (0.63)
Cumulative effect of change in accounting principle	—	—	—	(0.03)
	$ 0.01	$ (0.46)	$ (0.47)	$ (0.66)
Shares used in computation of earnings (loss) per share:				
Basic	371,420	368,052	359,752	357,424
Diluted	384,045	368,052	359,752	357,424

(1) The sum of quarterly per share amounts may not equal per share amounts reported for year-to-date periods. This is due to changes in the number of weighted-average shares outstanding and the effects of rounding for each period.

Item 9. ***Changes in and Disagreements with Accountants On Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

We carried out an evaluation required by 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 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 are effective in timely alerting them to material information required to be included in our periodic SEC reports. It should be noted that any system of controls is based in part upon certain assumptions designed to obtain reasonable (and not absolute) assurance as to its effectiveness, and there can be no assurance that any design will succeed in achieving its stated goals.

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.

PART III

Item 10. ***Directors and Executive Officers of the Registrant***

Information regarding our Executive Officers required by Item 10 of Part III is set forth in Item 1 of Part I "Business—Executive Officers and Directors." Information required by Item 10 of Part III regarding our Directors is included in our Proxy Statement relating to our 2004 annual meeting of shareholders, and is incorporated herein by reference. Information relating to our Code of Conduct and Ethics and to compliance with Section 16(a) of the 1934 Act is set forth in our Proxy Statement relating to our 2004 annual meeting of shareholders and is incorporated herein by reference.

Item 11. ***Executive Compensation***

Information required by Item 11 of Part III is included in our Proxy Statement relating to our 2004 annual meeting of shareholders and is incorporated herein by reference.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information required by Item 12 of Part III is included in our Proxy Statement relating to our 2004 annual meeting of shareholders and is incorporated herein by reference.

Item 13. ***Certain Relationships and Related Transactions***

Information required by Item 13 of Part III is included in our Proxy Statement relating to our 2004 annual meeting of shareholders and is incorporated herein by reference.

Item 14. ***Principal Accountant Fees and Services***

Information required by Item 14 of Part III is included in our Proxy Statement relating our 2004 annual meeting of shareholders and is incorporated herein by reference.

PART IV

Item 15. ***Exhibits, Financial Statement Schedules and Reports on Form 8-K***

(a) *List of Documents Filed as a Part of This Report:*

(1) *Index to Consolidated Financial Statements:*

Report of Ernst & Young LLP, Independent Auditors

Consolidated Statements of Cash Flows for each of the three years ended December 31, 2003

Consolidated Statements of Operations for each of the three years ended December 31, 2003

Consolidated Balance Sheets as of December 31, 2003 and 2002

Consolidated Statements of Stockholders' Deficit for each of the three years ended December 31, 2003

Notes to Consolidated Financial Statements

(2) *Index to Financial Statement Schedules:*

Schedule II—Valuation and Qualifying Accounts

All other schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto, or is not applicable or required.

(3) *Index to 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 Quarter 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 Quarter Ended March 31, 2002).
4.1	Indenture, dated as of May 8, 1998, between Amazon.com, Inc. and the Bank of New York, as trustee (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 1998).
4.2	Form of 10% Senior Discount Notes Due 2008 (incorporated by reference to the Company's Registration Statement on Form S-4 (Registration No. 333-56723) filed June 12, 1998).
4.3	Indenture, dated as of February 3, 1999, between Amazon.com, Inc. and The Bank of New York, as trustee, including the form of 4 3/4% Convertible Subordinated Notes Due 2009 attached as Exhibit A thereto (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.4	Registration Rights Agreement, dated February 3, 1999, by and among Amazon.com, Inc. and the Initial Purchasers (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.5	Indenture, dated as of February 16, 2000, between Amazon.com, Inc. and the Bank of New York, as trustee (incorporated by reference to the Company's Current Report on Form 8-K dated February 16, 2000).
4.6	Form of 6 7/8% Convertible Subordinated Notes due 2010 (incorporated by reference to the Company's Current Report on Form 8-K dated February 28, 2000).
10.1†	Amended and Restated 1994 Stock Option Plan (version as of December 20, 1996 for Amended and Restated Grants and version as of December 20, 1996 for New Grants) (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).

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Exhibit Number	Description
10.2†	1997 Stock Incentive Plan (incorporated by reference to Appendix B to the Company's Proxy Statement on Schedule 14A, filed with the Securities and Exchange Commission on March 29, 2000).
10.3†	1999 Non-Officer Employee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 333-74419) filed March 15, 1999).
10.4	Common Stock Purchase Agreement, dated July 23, 2001, between Amazon.com, Inc. and America Online, Inc. (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2001).
10.5†	Form of Indemnification Agreement between the Company and each of its Directors (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.6†	Offer Letter of Employment to Rick Dalzell, dated August 13, 1997 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 1999).
10.7†	Offer Letter of Employment to Diego Piacentini, dated January 17, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.8†	Executive Compensation Letter to Diego Piacentini, dated May 16, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.9†	Offer Letter of Employment to Thomas J. Szkutak, dated August 26, 2002 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.10†	Form of Restricted Stock Unit Agreement for Officers and Employees (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.11†	Form of Restricted Stock Unit Agreement for Directors (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.12†	Form of Restricted Stock Agreement (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2001).
12.1	Computation of Ratio of Earnings to Fixed Charges.
18.1	Preferability Letter of Ernst & Young LLP, Independent Auditors, regarding change in accounting principle (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2002).
21.1	List of Significant Subsidiaries.
23.1	Consent of Ernst & Young LLP, Independent Auditors.
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.

† Executive Compensation Plan or Agreement

(b) *Reports on Form 8-K:*

On October 21, 2003, we filed a Form 8-K announcing our third quarter 2003 financial results.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, as of February 24, 2004.

AMAZON.COM, INC.

By: /s/ JEFFREY P. BEZOS

Jeffrey P. Bezos
President, Chief Executive Officer
and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities indicated as of February 24, 2004.

Signature	Title
/s/ JEFFREY P. BEZOS Jeffrey P. Bezos	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
/s/ THOMAS J. SZKUTAK Thomas J. Szkutak	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ MARK S. PEEK Mark S. Peek	Vice President and Chief Accounting Officer (Principal Accounting Officer)
/s/ TOM A. ALBERG Tom A. Alberg	Director
/s/ L. JOHN DOERR L. John Doerr	Director
/s/ WILLIAM G. GORDON William G. Gordon	Director
/s/ THOMAS O. RYDER Thomas O. Ryder	Director
/s/ PATRICIA Q. STONESIFER Patricia Q. Stonesifer	Director

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AMAZON.COM, INC.
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Accounts receivable and other current assets —Reserves

Year Ended	Balance at Beginning of Period	Charged to Costs and Expenses	Amounts Written Off	Balance at End of Period
		(In thousands)		
December 31, 2003	$ 19,967	$ 17,788	$ (20,161)	$17,594
December 31, 2002	13,235	7,368	(636)	19,967
December 31, 2001	17,790	8,305	(12,860)	13,235

EXHIBIT INDEX

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 Quarter 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 Quarter Ended March 31, 2002).
4.1	Indenture, dated as of May 8, 1998, between Amazon.com, Inc. and the Bank of New York, as trustee (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 1998).
4.2	Form of 10% Senior Discount Notes Due 2008 (incorporated by reference to the Company's Registration Statement on Form S-4 (Registration No. 333-56723) filed June 12, 1998).
4.3	Indenture, dated as of February 3, 1999, between Amazon.com, Inc. and The Bank of New York, as trustee, including the form of 4 3/4% Convertible Subordinated Notes Due 2009 attached as Exhibit A thereto (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.4	Registration Rights Agreement, dated February 3, 1999, by and among Amazon.com, Inc. and the Initial Purchasers (incorporated by reference to the Company's Current Report on Form 8-K dated February 3, 1999).
4.5	Indenture, dated as of February 16, 2000, between Amazon.com, Inc. and the Bank of New York, as trustee (incorporated by reference to the Company's Current Report on Form 8-K dated February 16, 2000).
4.6	Form of 6 7/8% Convertible Subordinated Notes due 2010 (incorporated by reference to the Company's Current Report on Form 8-K dated February 28, 2000).
10.1†	Amended and Restated 1994 Stock Option Plan (version as of December 20, 1996 for Amended and Restated Grants and version as of December 20, 1996 for New Grants) (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.2†	1997 Stock Incentive Plan (incorporated by reference to Appendix B to the Company's Proxy Statement on Schedule 14A, filed with the Securities and Exchange Commission on March 29, 2000).
10.3†	1999 Non-Officer Employee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 333-74419) filed March 15, 1999).
10.4	Common Stock Purchase Agreement, dated July 23, 2001, between Amazon.com, Inc. and America Online, Inc. (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2001).
10.5†	Form of Indemnification Agreement between the Company and each of its Directors (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-23795) filed March 24, 1997).
10.6†	Offer Letter of Employment to Rick Dalzell, dated August 13, 1997 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 1999).
10.7†	Offer Letter of Employment to Diego Piacentini, dated January 17, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).
10.8†	Executive Compensation Letter to Diego Piacentini, dated May 16, 2000 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2000).

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Exhibit Number	Description
10.9†	Offer Letter of Employment to Thomas J. Szkutak, dated August 26, 2002 (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.10†	Form of Restricted Stock Unit Agreement for Officers and Employees (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.11†	Form of Restricted Stock Unit Agreement for Directors (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2002).
10.12†	Form of Restricted Stock Agreement (incorporated by reference to the Company's Annual Report on Form 10-K for the Year Ended December 31, 2001).
12.1	Computation of Ratio of Earnings to Fixed Charges.
18.1	Preferability Letter of Ernst & Young LLP, Independent Auditors, regarding change in accounting principle (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2002).
21.1	List of Significant Subsidiaries.
23.1	Consent of Ernst & Young LLP, Independent Auditors.
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.

† Executive Compensation Plan or Agreement

Exhibit 12.1 Ratio of Earnings To Fixed Charges

	Year Ended December 31,				
	2003	2002	2001	2000	1999
			(amounts in thousands)		
Net Income (loss)	$ 35,282	$(149,132)	$(567,277)	$(1,411,273)	$(719,968)
Equity in losses of equity-method investees	436	4,169	30,327	304,596	76,769
Net Income (loss) before equity in losses of equity-method investees	35,718	(144,963)	(536,950)	(1,106,677)	(643,199)
Plus fixed charges:					
Interest expense including amortization of debt issuance costs	129,979	142,925	139,232	130,921	84,566
Assumed interest element included in rent expense	5,718	6,205	8,880	10,773	4,732
	135,697	149,130	148,112	141,694	89,298
Adjusted earnings (loss)	171,415	4,167	(388,838)	(964,983)	(553,901)
Fixed charges	(135,697)	(149,130)	(148,112)	(141,694)	(89,298)
Excess (deficiency) of earnings to cover fixed charges	$ 35,718	$(144,963)	$(536,950)	$(1,106,677)	$(643,199)
Ratio of earnings to fixed charges (1)	1.26	0.03	(2.63)	(6.81)	(6.20)

(1) The ratio of earnings to fixed charges is computed by dividing (i) income (loss) before income taxes and losses from equity interests, plus fixed charges by (ii) fixed charges.

Exhibit 21.1

AMAZON.COM, INC.
LIST OF SIGNIFICANT SUBSIDIARIES

Legal Name	Jurisdiction	Percent Owned
Alexa Internet	California	100%
Amazon Fulfillment Services, Inc.	Delaware	100%
Amazon Global Resources, Inc.	Delaware	100%
Amazon Services, Inc.	Nevada	100%
Amazon.com TC 2, Inc.	Delaware	100%
Amazon.com.dedc, LLC	Delaware	100%
Amazon.com.ksdc, Inc.	Delaware	100%
Amazon.com@Target.com, Inc.	Delaware	100%
Amazon.fr SARL	France	100%
Amazon.co.uk, Ltd.	United Kingdom	100%
Borders Teamed with Amazon.com, Inc.	Delaware	100%
CD Amazon Now, Inc.	Delaware	100%
Fulfillco.tnds, Inc.	Delaware	100%
Amazon.com Holdings, Inc.	Delaware	100%
Internet Movie Database, Inc.	Nevada	100%
Amazon Japan K.K.	Japan	100%
Amazon.com.kydc, Inc.	Delaware	100%
Amazon.com.nddc, Inc.	Delaware	100%
Amazon.com.nvdc, Inc.	Delaware	100%
NV Services, Inc.	Nevada	100%
Amazon.com LLC	Delaware	100%
Amazon.com Int'l Sales, Inc.	Delaware	100%
Amazon.com Int'l Marketplace, Inc.	Delaware	100%
Amazon.com.ca, Inc.	Delaware	100%

Exhibit 23.1

Consent of Ernst & Young LLP, Independent Auditors

We consent to the incorporation by reference in the (a) Registration Statement (Form S-4 No. 333-55943), as amended, pertaining to the acquisition shelf-registration of up to 30 million shares of common stock, (b) Registration Statement (Form S-8 No. 333-28763) pertaining to the 1997 Stock Option Plan of Amazon.com, Inc. and the Amended and Restated 1994 Stock Option Plan of Amazon.com, Inc., (c) Registration Statement (Form S-8 No. 333-88825) pertaining to the Convergence Corporation Stock Option Plan, (d) Registration Statement (Form S-8 No. 333-80491) pertaining to the Alexa Internet Amended and Restated 1997 Stock Option Plan, (e) Registration Statement (Form S-8 No. 333-80495) pertaining to the Accept.com Financial Services Corporation 1998 Stock Option Plan, (f) Registration Statement (Form S-3 No. 333-78797), as amended, pertaining to the shelf registration of up to $2,000,000,000 of certain securities, (g) Registration Statement (Form S-8 No. 333-78651) pertaining to the LiveBid.com 1997 Stock Option Plan and Innerlinx Technologies, Incorporated 1997 Stock Option Plan, (h) Registration Statement (Form S-8 No. 333-78653) pertaining to the eNiche Incorporated Amended and Restated 1998 Stock Option and Grant Plan, (i) Registration Statement (Form S-8 No. 333-74419) pertaining to the Amazon.com, Inc. 1999 Non-officer Employee Stock Option Plan, (j) Registration Statement (Form S-8 No. 333-63311) pertaining to the Junglee Corp. 1996 Stock Plan, the Junglee Corp. 1998 Equity Incentive Plan, the Sage Enterprises, Inc. 1997 Amended Stock Option Plan, and the Sage Enterprises, Inc. MVP Stock Option Plan, and (k) Registration Statement (Form S-8 No. 333-59958) pertaining to the Amazon.com Inc. 2001 Stakeholder Trust Plan, of our report dated January 23, 2004, except for the last two paragraphs of Note 6 and Note 17, as to which the date is January 27, 2004, with respect to the consolidated financial statements and schedule of Amazon.com, Inc. included in this Annual Report (Form 10-K) of Amazon.com, Inc. for the year ended December 31, 2003.

/s/ ERNST & YOUNG LLP

Seattle, Washington
February 24, 2004

CERTIFICATIONS

I, Jeffrey P. Bezos, certify that:

1. I have reviewed this Form 10-K of Amazon.com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ JEFFREY P. BEZOS

Jeffrey P. Bezos
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: February 24, 2004

CERTIFICATIONS

I, Thomas J. Szkutak, certify that:

1. I have reviewed this Form 10-K of Amazon.com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ THOMAS J. SZKUTAK

Thomas J. Szkutak
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: February 24, 2004

Exhibit 32.1

Certification Pursuant to 18 U.S.C. Section 1350

In connection with the Annual Report of Amazon.com, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003 as filed with the SEC on or about the date hereof (the "Report"), I, Jeffrey P. Bezos, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC or its staff upon request.

/s/ JEFFREY P. BEZOS

Jeffrey P. Bezos
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: February 24, 2004

Certification Pursuant to 18 U.S.C. Section 1350

In connection with the Annual Report of Amazon.com, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003 as filed with the Securities and Exchange Commission (the "SEC") on or about the date hereof (the "Report"), I, Thomas J. Szkutak, Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC or its staff upon request.

/s/ THOMAS J. SZKUTAK

Thomas J. Szkutak
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: February 24, 2004

Amazon Technologies, Inc. v. Jeffrey S. Wax
Opposition No. 91187118

EXHIBIT 45

UNITED STATES OF AMERICA

SECURITIES AND EXCHANGE COMMISSION

ATTESTATION

I HEREBY ATTEST

that:

Attached is a copy of, annual report on Form 10-K, for the fiscal year ended December 31, 2002, received in this Commission February 19, 2003, under the name Amazon.Com, Inc., File No. 0-22513, pursuant to the provisions of the Securities Exchange Act of 1934.

~~on~~ file in this Commission

October 18, 2010

(Date)

Larry Mills
Records Officer

It is hereby certified that the Secretary of the U.S. Securities and Exchange Commission, Washington, D.C., which Commission was created by the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is official custodian of the records and files of said Commission, and all records and files created or established by the Federal Trade Commission pursuant to the provisions of the Securities Act of 1933 and transferred to this Commission in accordance with Section 210 of the Securities Exchange Act of 1934, and was such official custodian at the time of executing the above attestation, and that he/she, and persons holding the positions of Deputy Secretary, Assistant Director, Records Officer, Branch Chief of Records Management, and the Program Analyst for the Records Officer, or any one of them, are authorized to execute the above attestation.

For the Commission

Secretary

SEC 334 (10/07)

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

Form 10-K

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2002

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)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $.01 per share

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes ☐ No ☑

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☑ No ☐

Aggregate market value of voting stock held by non-affiliates of the registrant as of June 28, 2002	$4,311,000,000
Number of shares of common stock outstanding as of January 27, 2003	388,242,957

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of stockholders to be held in 2003, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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AMAZON.COM, INC.

FORM 10-K
For the Fiscal Year Ended December 31, 2002

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PART I

Item 1. *Business*

This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements based on expectations, estimates and projections as of the date of this filing. Actual results may differ materially from those expressed in forward-looking statements. See Item 7 of Part II — "Management's Discussion and Analysis of Financial Condition and Results of Operations — Forward-Looking Statements."

General

Amazon.com, Inc., a Fortune 500 company, commenced operations on the World Wide Web in July 1995. We seek to offer Earth's Biggest Selection and to be Earth's most customer-centric company, where customers can find and discover anything they may want to buy online. We endeavor to offer our customers the lowest possible prices. We and our sellers list millions of unique new, used and collectible items in categories such as apparel and accessories, electronics, computers, kitchen and housewares, books, music, DVDs, videos, cameras and photo items, office products, toys, baby items and baby registry, software, computer and video games, cell phones and service, tools and hardware, travel services, magazine subscriptions and outdoor living items. Through our Merchants@ and Amazon Marketplace programs, zShops and Auctions, any business or individual can sell virtually anything to Amazon.com's millions of customers.

We operate six global Web sites: *www.amazon.com*, *www.amazon.co.uk*, *www.amazon.de*, *www.amazon.fr*, *www.amazon.co.jp* and *www.amazon.ca*. We also own and operate the Internet Movie Database at *www.imdb.com* ("IMDb"), which is a comprehensive and authoritative source of information on movie and entertainment titles and cast and crew members. IMDb offers IMDb Pro, a subscription service designed for the entertainment industry.

Amazon.com was incorporated in 1994 in the state of Washington and reincorporated in 1996 in the state of Delaware. Our principal corporate offices are located in Seattle, Washington. We completed our initial public offering in May 1997 and our common stock is listed on the Nasdaq National Market under the symbol "AMZN."

As used herein, "Amazon.com," "we," "our" and similar terms include Amazon.com, Inc. and its subsidiaries, unless the context indicates otherwise.

Business Strategy

We seek to offer Earth's Biggest Selection and to be Earth's most customer-centric company, where customers can find and discover anything they might want to buy online. We have designed our Web sites to allow millions of new, used and collectible products to be sold by us and by other businesses and individuals worldwide. A product on our Web sites may be listed for sale simultaneously by several different sellers. For instance, a product may be offered by us, by a participant in our Merchants@ program and by a business or individual selling a new, used or collectible version of the product through Amazon Marketplace, zShops or Auctions. We also offer certain e-commerce services to other businesses through our Merchant.com and Syndicated Stores programs.

Lowering Prices

We endeavor to offer our customers the lowest possible prices. We strive to improve our operating efficiencies and to leverage our fixed costs so that we can afford to pass along these savings to our customers in the form of lower prices. We believe this strategy of lowering prices will, over time, increase unit growth and lead to further efficiencies.

Amazon.com Retail

We are the seller of record on our Web sites for a broad range of new products, including electronics, computers, kitchen and housewares, books, music, DVDs, videos, cameras and photo items, software, computer and video games, cell phones, tools and hardware and outdoor living items. We purchase these products from vendors and fulfill them either through our fulfillment centers or through outsourced fulfillment providers.

Merchants@ and Amazon Marketplace Programs

Our Merchants@ and Amazon Marketplace programs allow other businesses and individuals to offer their new, used and collectible products for sale on our Web sites. Their products are fully integrated on our Web sites and are purchased by customers through a single checkout process. We are not the seller of record in these transactions, but instead earn fixed fees, sales commissions, per-unit activity fees, or some combination thereof. We also sometimes offer fulfillment-related services under this program. Examples of our Merchants@ program include our apparel store at *www.amazon.com*, which offers more than 500 brands, as well as the Toysrus.com, Babiesrus.com and Target stores at *www.amazon.com*. Amazon Marketplace is available on *www.amazon.com*, *www.amazon.co.uk*, *www.amazon.de* and *www.amazon.co.jp*. In addition, other businesses and individuals can auction products through our Auction sites and offer products on individual specialty stores through our zShops sites.

Merchant.com Program

Through our Merchant.com program we utilize our e-commerce services, features and technologies to operate another business's Web site and sell its products under its brand name and URL (an example is *www.target.com*). We also offer fulfillment-related services through our Merchant.com program. We are not the seller of record, but instead earn fixed fees, sales commissions, per-unit activity fees, or some combination thereof.

Syndicated Stores Program

Through our Syndicated Stores program, we utilize our e-commerce services, features and technologies to sell our products through another business's Web site using another business's name and URL. Under these arrangements, we are the seller of record and are responsible for fulfillment and customer service. The other business earns a sales commission on the products sold. Examples include *www.cdnow.com*, *www.virginmega.com*, *www.virginmega.co.jp*, *www.borders.com*, *www.waldenbooks.com* and *www.waterstones.co.uk*, among others.

Operating Segments

Beginning in 2001, we organized our operations into four principal segments: North America Books, Music and DVD/ Video ("BMVD"); North America Electronics, Tools and Kitchen ("ETK"); International; and Services. See Item 8 of Part II, "Financial Statements and Supplementary Data — Notes to Consolidated Financial Statements — Note 15 — Segment Information" for additional information regarding our segments.

BMVD Segment. This segment includes retail sales from *www.amazon.com* and *www.amazon.ca* of books, music and DVD/video products and magazine subscription commissions. This segment also includes commissions from sales of these products, new, used or collectible, through Amazon Marketplace and amounts earned from sales of these products by other businesses through our Merchants@ program and product revenues from stores offering these products through our Syndicated Stores program.

Our BMVD segment had net sales of $1.87 billion, $1.69 billion and $1.70 billion in 2002, 2001 and 2000, respectively. In 2002, we launched our Canada-focused Web site at *www.amazon.ca* and launched Syndicated Stores at *www.cdnow.com* and *www.waldenbooks.com*. In addition, we added in-store pickup to

our *www.borders.com* Syndicated Store and added over 50,000 magazine, newspaper and newsletter titles to our Magazine store at *www.amazon.com*.

ETK Segment. This segment includes *www.amazon.com* retail sales of electronics, home improvement and home and garden products, as well as our mail-order catalog sales. This segment also includes commissions from sales of these products, new, used or collectible, through Amazon Marketplace and amounts earned from sales of these products by other businesses through our Merchants@ program, such as with Office Depot, and will include revenues from stores offering these products, if any, through our Syndicated Stores program.

Our ETK segment had net sales of $645 million, $547 million and $484 million in 2002, 2001 and 2000, respectively. During 2002, we launched our Office Depot store at *www.amazon.com*.

International Segment. This segment includes all retail sales of the following internationally-focused Web sites: *www.amazon.co.uk, www.amazon.de, www.amazon.fr* and *www.amazon.co.jp*. These international sites share a common Amazon.com experience, but are localized in terms of language, products, customer service and fulfillment. To the extent available on these sites, this segment includes commissions and other amounts earned from sales of products through Amazon Marketplace and product revenues from stores offering products through our Syndicated Stores program, such as *www.waterstones.co.uk* and *www.virginmega.co.jp*, and amounts earned from sales of products by other businesses through our Merchants@ program.

Our International segment includes export sales from *www.amazon.co.uk, www.amazon.de, www.amazon.fr* and *www.amazon.co.jp* (including export sales from these sites to customers in the U.S. and Canada), but excludes export sales from *www.amazon.com* and *www.amazon.ca*. Our International segment had net sales of $1.17 billion, $661 million and $381 million in 2002, 2001 and 2000, respectively. In 2002, *www.amazon.co.uk, www.amazon.de* and *www.amazon.co.jp* each launched Amazon Marketplace. In addition, the Syndicated Store at *www.virginmega.co.jp* was launched, and *www.amazon.de* launched a magazine and periodicals store.

Services Segment. This segment consists of commissions, fees and other amounts earned from our services business, including our Merchant.com program (such as *www.target.com*), and to the extent full product categories are not also offered by us through our online retail stores, our Merchants@ program, such as our apparel store, the Toysrus.com and Babiesrus.com stores, and portions of the Target store at *www.amazon.com*, as well as our commercial agreement with America Online, Inc. This segment also includes Auctions, zShops, Amazon Payments and miscellaneous marketing and promotional agreements.

The Services segment had net sales of $246 million, $225 million and $198 million in 2002, 2001 and 2000, respectively. In 2002, we launched our apparel store which now has more than 500 popular brands of clothing, shoes and accessories offered by our Merchants@ program participants. In addition, we launched *www.target.com* under our Merchant.com program.

Amazon.com Web Sites

Our Web sites promote brand loyalty and repeat purchases by providing feature-rich content, a secure and trusted transaction environment and easy-to-use functionality. Our Web sites offer broad selection, low prices, availability, convenience, discovery and fulfillment. Key features include product reviews and other information, Web pages tailored to individual customers' preferences, including recommendations and notifications, 1-Click® technology, secure payment systems, browsing, searching and the ability to view selected interior pages of over 250,000 books with our "Look Inside the Book" feature. Our community of online users creates feature-rich content, including product reviews and online lists, such as wish lists, wedding registries and baby registries of desired products and services that others can reference for gift-giving purposes and Listmania lists with accompanying commentary regarding favorite products.

Marketing and Promotion

Our marketing strategy is designed to strengthen and broaden the Amazon.com brand name, increase customer traffic to our Web sites, encourage customers to shop in many product categories, promote repeat purchases and develop incremental product and service revenue opportunities. First and foremost, our best marketing efforts are focused on improving the customer experience, which drives word-of-mouth promotion and repeat customer visits. We also deliver personalized Web pages and services and employ a variety of media, business development activities and promotional methods to achieve these goals. We benefit from public relations activities and from time to time we employ various means of online and traditional advertising, including e-mail, radio, television and print media and direct marketing. We also participate in cooperative advertising arrangements with certain of our vendors. We direct customers to our Web sites through our Associates program, which enables associated Web sites to make our products available to their audiences with fulfillment performed by us. Currently, over 900,000 Web sites have enrolled in our Associates program. In addition, we offer an everyday free shipping option at *www.amazon.com* for certain orders that exceed a specific amount, and offer similar options for our internationally-focused Web sites. Although marketing expenses do not include our free and reduced shipping offers, we view such offers as an effective marketing tool.

Customer Service

We believe that our ability to establish and maintain long-term relationships with our customers and to encourage repeat visits and purchases depends, in part, on the strength of our customer service operations, and we continually seek to improve the Amazon.com customer service experience. Customers can use the "your-account" website features to track order and shipment status, review estimated delivery dates, cancel unshipped items, change delivery information and payment options, combine orders, edit gift options and return items. In addition to these and similar online self-service features, users can contact customer service representatives 24 hours a day, seven days a week. We have automated certain tools used by our customer service staff and have plans for further enhancements. We currently have customer service personnel working in six customer service centers located in Tacoma, Washington; Grand Forks, North Dakota; Huntington, West Virginia; Slough, the United Kingdom; Regensburg, Germany; and Sapporo, Japan. In addition, we have customer-service cosourcing arrangements with certain vendors in India, Northern Ireland and the U.S.

Fulfillment

We currently lease and operate U.S. fulfillment facilities in New Castle, Delaware; Coffeyville, Kansas; Campbellsville and Lexington, Kentucky; Fernley, Nevada; and Grand Forks, North Dakota. We also lease and operate three European fulfillment centers that are located in Marston Gate, the United Kingdom; Orleans, France; and Bad Hersfeld, Germany. In Japan, Nippon Express, a leading courier company, provides fulfillment services for orders from *www.amazon.co.jp* under a cosourcing arrangement; and in Canada, Assured Logistics, an affiliate of Canada Post, provides outsourced fulfillment services for orders from *www.amazon.ca*. On an aggregate basis, these fulfillment centers (including the facilities that are leased by Nippon Express and Assured Logistics) comprise approximately 4.2 million square feet of warehouse space. In addition, we currently lease six off-site facilities totaling approximately 1.1 million square feet of space, which support the storage and fulfillment functions of our U.S. fulfillment centers. Our fulfillment centers facilitate our ability to deliver merchandise to customers on a reliable and timely basis. In addition, we fulfill certain orders through outsourced fulfillment providers.

Seasonality

Our business is generally affected by both seasonal fluctuations in Internet usage (which generally declines during summer months) and traditional retail seasonality. Traditional retail sales for most of our products (including books, music, DVDs, videos, toys and electronics, among others) usually increase significantly in the fourth calendar quarter of each year. Of particular note is the fourth quarter seasonal

effect on our sales of toys (which are mainly sold through our Merchants@ program relationship with Toysrus.com) and electronics.

Technology

We have implemented numerous Web-site management, search, customer interaction, recommendation, transaction-processing and fulfillment services and systems using a combination of our own proprietary technologies and commercially available, licensed technologies. Our current strategy is to focus our development efforts on creating and enhancing the specialized, proprietary software that is unique to our business and to license or acquire commercially-developed technology for other applications where available and appropriate.

We use a set of applications for accepting and validating customer orders, placing and tracking orders with suppliers, managing and assigning inventory to customer orders and ensuring proper shipment of products to customers. Our transaction-processing systems handle millions of items, a number of different status inquiries, gift-wrapping requests and multiple shipment methods. These systems allow the customer to choose whether to receive single or several shipments based on availability and to track the progress of each order. These applications also manage the process of accepting, authorizing and charging customer credit cards.

Competition

The retail environment for our products is generally intensely competitive. Our current or potential competitors include: (1) physical-world retailers, catalog retailers, publishers, distributors and manufacturers of our products, many of which possess significant brand awareness, sales volume and customer bases, and some of which currently sell, or may sell, products or services through the Internet, mail order or direct marketing; (2) other online e-commerce sites; (3) a number of indirect competitors, including Web portals and Web search engines that are involved in online commerce, either directly or in collaboration with other retailers; and (4) companies that provide e-commerce services, including Web-site developers and third-party fulfillment and customer-service providers. We believe that the principal competitive factors in our market segments include selection, price, availability, convenience, information, discovery, brand recognition, personalized services, accessibility, customer service, reliability, speed of fulfillment, ease of use and ability to adapt to changing conditions. For services we offer to business and individual sellers, additional competitive factors include the quality of our services and tools and speed of performance for our services. As the market segments in which we operate continue to grow, other companies may also enter into business combinations or alliances that strengthen their competitive positions.

Intellectual Property

We regard our trademarks, service marks, copyrights, patents, domain names, trade dress, trade secrets, proprietary technologies and similar intellectual property as critical to our success, and we rely on trademark, copyright and patent law, trade-secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. We have registered a number of domain names and been issued a number of trademarks, service marks, patents and copyrights by U.S. and foreign governmental authorities. We also have applied for the registration of other trademarks, service marks, domain names and copyrights in the U.S. and internationally, and we have filed U.S. and international patent applications covering certain of our proprietary technology. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights, such as trademarks, patents, technologies or copyrighted materials, to third parties.

Employees

We employed approximately 7,500 full-time and part-time employees at December 31, 2002. However, employment levels fluctuate due to seasonal factors affecting our business. We also employ independent contractors and temporary personnel on a seasonal basis. None of our employees is

represented by a labor union and we consider our employee relations to be good. Competition for qualified personnel in our industry is intense, particularly for software-development and other technical staff. We believe that our future success will depend in part on our continued ability to attract, hire and retain qualified personnel.

Available Information

Our investor relations website is *www.amazon.com/ir*. We make available on this website under "Financial Documents and Annual Reports," free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the U.S. Securities and Exchange Commission ("SEC").

Additional Factors That May Affect Future Results

The following risk factors and other information included in this Annual 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 Have an Accumulated Deficit and May Incur Additional Losses

We have incurred significant losses since we began doing business. As of December 31, 2002, we had an accumulated deficit of $3.0 billion and our stockholders' equity was a deficit of $1.4 billion. We have incurred substantial operating losses since our inception, and we may continue to incur such losses for the foreseeable future.

We Have Significant Indebtedness

As of December 31, 2002, we had total long-term indebtedness under our 10% Senior Discount Notes due 2008 ("Senior Discount Notes"), convertible notes, capitalized-lease obligations and other asset financings of $2.3 billion. We make annual or semi-annual interest payments on the indebtedness under our two tranches of convertible notes, which are due in 2009 and 2010, respectively. Beginning in November 2003, we will begin to make semi-annual interest payments on the indebtedness under our Senior Discount Notes. We may incur substantial additional debt in the future. Our indebtedness could limit our ability to obtain necessary additional financing for working capital, capital expenditures, debt service requirements or other purposes in the future; plan for, or react to, changes in technology and in our business and competition; and 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.

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 and marketing than us.

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 may further intensify the competitive nature of online retail. 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 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. 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 Web sites; and powering third-party Web sites, either with or without providing accompanying fulfillment services. These arrangements are complex and initially 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 deliver services under the relevant agreements. If we fail to implement, maintain and develop successfully the various components of such arrangements, which may include fulfillment, customer service, inventory management, tax collection, payment processing and licensing of third party software, hardware and content, these initiatives may not be viable. The amount of compensation we receive under certain of these agreements is dependent on the volume of sales that the other company makes. Therefore, if the other business's Web site 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 our commercial 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 these agreements or encounter other parties that have difficulty meeting their contractual obligations to us, which could adversely affect our operating results.

In addition, our present and future third-party services agreements, other commercial agreements, joint ventures, investments and business combinations create risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- impairment of relationships with existing employees, customers and companies with which we have formed strategic alliances;
- variability in revenue and income from entering into, amending or terminating such agreements or relationships;
- difficulty assimilating the operations, technology and personnel of combined companies;
- problems retaining key technical and managerial personnel; and
- additional operating losses and expenses of acquired businesses.

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 where 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 Web site 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 in the future make additional investments in companies with which we already have commercial agreements or companies with which we enter into new commercial agreements or similar arrangements. 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 has been 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 that are not accounted for under the equity method are included in "Marketable securities" and "Other equity investments" on our 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 other of these investments have experienced an other-than-temporary decline. As of December 31, 2002, our recorded basis in equity securities was $19 million, including $4 million classified as "Marketable securities" and $15 million classified as "Other equity investments," of which less than $1 million was accounted for under the equity-method.

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 and 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 partial shipments from one or more locations. We may experience a decline in our shipping margins 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 Web sites within a short period of time due to increased holiday or other demand, we may experience system interruptions that make our Web sites unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. 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 outsourcers, 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 reach their highest level (other than as a result of cash flows provided by investing and financing activities). This operating cycle results in a corresponding increase in accounts payable. Our accounts payable balance will decline during the first three months following year-end, which will result in a decline in the amount of cash, cash equivalents and marketable securities on hand.

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. Our expenses and investments are to a large extent fixed. 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 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 attacks and security concerns could create delays in and increase the cost of product shipments to and from us, 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 strategic alliances;
- foreign exchange rate fluctuations;
- our ability to acquire merchandise, manage inventory and fulfill orders;
- the introduction by our competitors of Web sites, products or services;
- changes in usage of the Internet and online services and consumer acceptance of the Internet and e-commerce;
- timing and costs of upgrades and developments in our systems and infrastructure;
- the effects of strategic alliances, acquisitions and other business combinations, and our ability to successfully integrate them into our business;
- 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 promotions; and

- an increase in the prices of fuel and gasoline, which are used in the transportation of packages, as well as an increase in the prices of other energy products, primarily natural gas and electricity, which are used in our operating facilities.

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 Have Foreign Exchange Risk

The results of operations of our internationally-focused Web sites are exposed to foreign exchange rate fluctuations as the financial results of the applicable subsidiaries are translated from the local currency into U.S. Dollars upon consolidation. As exchange rates vary, net sales and other operating results, when translated, may differ materially from expectations.

In addition, our 6.875% Convertible Subordinated Notes due 2010 ("6.875% PEACS") are denominated in Euros, not U.S. Dollars. When we periodically remeasure the principal of the 6.875% PEACS based on fluctuations in the Euro/ U.S. Dollar exchange ratio, we will record non-cash gains or losses in "Other gains (losses), net" on our statements of operations. Furthermore, we have invested some of the proceeds from the 6.875% PEACS in Euro-denominated cash equivalents and marketable securities. Accordingly, if the U.S. Dollar strengthens compared to the Euro, cash equivalents and marketable securities balances, when translated, may be materially less than expected and vice versa.

Our Past and Planned Future Growth Will Place a Significant Strain on our Management, Operational and Financial Resources

We have rapidly and significantly expanded our operations and will endeavor to expand further to pursue growth of our product and service offerings and customer base. Such growth will continue to place a significant strain on our management, operational and financial resources. We also need to train and manage our employee base. Our current and planned personnel, systems, procedures and controls may not be adequate to support and effectively manage our future operations. We may not be able to hire, train, retain, motivate and manage required personnel, which may limit our growth.

In addition, we do not expect to benefit in our newer market segments from the first-to-market advantage that we experienced in the 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 our customers may not favorably receive our new businesses. To the extent we pursue strategic alliances to facilitate new product or service activities, the alliances may not be successful. If any of this were to occur, it could damage our reputation and negatively affect revenue growth.

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 Web sites directly affects the volume of goods we sell and the services we offer and thus affects our net sales. We experience occasional system interruptions that make our Web sites unavailable or 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. To prevent system

interruptions, we continually need to add additional software and hardware and upgrade our systems and network infrastructure to accommodate both increased traffic on our Web sites and increased sales volume.

Our computer and communications systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, break-ins, 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 to remedy.

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

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 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 Web sites, 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);
- import or export licensing requirements;
- limitations on the repatriation of funds;
- difficulty in obtaining distribution and support;
- nationalization;
- longer receivable cycles;
- consumer protection laws and restrictions on pricing or discounts;
- lower level of adoption or use of the Internet and other technologies vital to our business and the lack of appropriate infrastructure to support widespread Internet usage;
- lower level of credit card usage and increased payment risk;
- difficulty in developing and simultaneously managing a larger number of unique foreign operations as a result of distance, language and cultural differences;
- 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 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.

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 is particularly difficult to forecast product demand accurately. A failure to optimize inventory within our fulfillment network will harm our shipping margins 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 Merchants@ program relationships with Toysrus.com, Babiesrus.com, Target and other companies, these parties identify, buy, manage 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 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.

Our ability to receive inbound inventory efficiently or ship completed orders to customers may be negatively affected by a number of factors, including dependence on a limited number of shipping companies, inclement weather, fire, flood, power loss, earthquakes, labor disputes, acts of war or terrorism or acts of God.

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

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 sales volume, we may not manage our facilities in an optimal way, which may result in excess or insufficient inventory, warehousing, fulfillment and distribution capacity. In addition, 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. Finally, 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.

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. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, we cannot be certain that the steps we take to protect our intellectual property will adequately protect our rights or that others will not independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights.

Third parties that license our proprietary rights may take actions that diminish the value of our proprietary rights or reputation. In addition, the steps we take to protect our proprietary rights may not be adequate and third parties may infringe or misappropriate our copyrights, trademarks, trade dress, patents and similar proprietary rights. Other parties may claim that we infringed 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 which 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, as an e-commerce company, we have 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

- news and securities analyst reports and speculation relating to new and existing commercial agreements, general business or Internet trends or our existing or future products or services.

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. In the first quarter of 2001, we offered a limited non-compulsory exchange of employee stock options. This option exchange offer resulted in variable accounting treatment for certain of our stock options. Variable accounting treatment will result in unpredictable stock-based compensation expense dependent on fluctuations in quoted prices for our common stock. In late 2002, we implemented a restricted stock unit plan, which will be our primary vehicle for employee stock-based compensation going forward. Restricted stock and restricted stock units are measured at fair value on the date of grant based on the number of shares granted and the quoted price of the common stock, which will be recognized as compensation expense ratably over the corresponding employee service term.

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, user privacy, pricing, content, copyrights, distribution, electronic contracts, consumer protection, the provision of online payment services, broadband residential Internet access 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 consumer-to-consumer fixed price online markets, like zShops and certain aspects of Amazon Marketplace. This could, in turn, diminish the demand for our products and services and increase our cost of doing business.

We May Be Subject to Liability for Past Sales and Our Future Sales May Decrease

In accordance with current industry practice, we do not collect sales taxes or other taxes with respect to shipments of most of our goods into states other than Washington and North Dakota. 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. We collect Value Added Tax, or VAT, for products that are ordered on *www.amazon.co.uk*, *www.amazon.de* and *www.amazon.fr* and delivered in European Union member countries. We also collect Japanese consumption tax for products that are ordered on *www.amazon.co.jp* and delivered in Japan. In addition, Canadian consumption taxes are collected on sales of products that are ordered on *www.amazon.ca* and delivered in Canada. 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. One or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies which engage in 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 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 states other than Washington and North Dakota. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us and could decrease our future sales.

Various countries are currently evaluating their VAT positions on e-commerce transactions. Recently, for example, the European Union ("EU") enacted a directive requiring that businesses in non-EU countries selling digital products and services to EU resident consumers collect and remit VAT in the country of the consumer's residence. This directive will become effective on July 1, 2003, will result in additional VAT collection obligations and administrative burdens and may decrease our future sales to customers in the EU. Future VAT legislation or changes to our business model may have similar impacts.

We Source a Significant Portion of Our Inventory from a Few Vendors

Although we continue to increase our direct purchasing from manufacturers, we still source a significant amount of inventory from relatively few vendors. During 2002, we purchased over 10% of all inventory purchases from a single vendor, Ingram Book Group. No other vendors account for over 10%. 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 our products, such as toys, tools, hardware, computers, cell phones, and kitchen and houseware products, 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 may sell products that may indirectly increase our exposure to product liability 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 suppliers do not indemnify us from product liability.

We Could Be Liable for Breaches of Security on Our Web Site and Fraudulent Activities of Users of Our Amazon Payments Program

A fundamental requirement for e-commerce is the secure transmission of confidential information over public networks. 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.

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. We guarantee payments made through Amazon Payments up to certain limits for both buyers and sellers, and we may be unable to prevent users of Amazon Payments from fraudulently receiving goods when payment may not be made to a seller or fraudulently collecting payments when goods may not be shipped to a buyer. Our liability risk will increase if a larger fraction of our sellers use Amazon Payments. Any costs we incur as a result of liability because of our guarantee of payments made through Amazon Payments or otherwise could harm our business. In addition, the functionality of Amazon Payments depends on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, Amazon Payments will not be viable (and our businesses that use Amazon Payments may not be viable).

We 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 Web sites and proprietary technology obsolete.

The Internet as a Medium for Commerce Is Uncertain

Consumer use of the Internet as a medium for commerce is a recent phenomenon and is subject to a high level of uncertainty. While the number of Internet users has been rising, the Internet infrastructure may not expand fast enough to meet the increased levels of demand. If use of the Internet as a medium for commerce does not continue to grow or grows at a slower rate than we anticipate, our sales would be lower than expected and our business would be harmed.

We Could Be Liable for Unlawful or Fraudulent Activities by Users of Our Merchants@ program, Merchant.com program, Amazon Marketplace, Auctions and zShops Services

We may be unable to prevent users of our Merchants@ program, Merchant.com program, Amazon Marketplace, Auctions and zShops services from selling unlawful goods, or from selling goods in an unlawful manner. We may face civil or criminal liability for unlawful and fraudulent activities by our users under U.S. laws and/or the laws and regulations of other countries. In addition, if we are unsuccessful in preventing our users from providing content that is either illegal or which violates the proprietary rights of others, it may result in liability to us. Any costs we incur as a result of liability relating to the sale of unlawful goods, the unlawful sale of goods, the fraudulent receipt of goods or the fraudulent collection of payments could harm our business. In running our Merchants@ program, Merchant.com program, Amazon Marketplace, Auctions and zShops services, we rely on sellers to make accurate representations and provide reliable delivery, and on buyers to pay the agreed purchase price. We do not take responsibility for delivery of payment or goods and, while we can suspend or terminate the accounts of users who fail to fulfill their delivery obligations, we cannot require users to make payments or deliver goods. We do not compensate users who believe they have been defrauded by other users except through our guarantee program. Under our guarantee program, fraudulent activities by our users, such as the fraudulent receipt of goods and the fraudulent collection of payments, may create liability for us.

Executive Officers and Directors

The following tables set forth certain information regarding our Executive Officers and Directors as of January 19, 2003:

Executive Officers

Name	Age	Position
Jeffrey P. Bezos	39	President, Chief Executive Officer and Chairman of the Board
Richard L. Dalzell	45	Senior Vice President, Worldwide Architecture and Platform Software and Chief Information Officer
Mark S. Peek	45	Vice President and Chief Accounting Officer
Diego Piacentini	42	Senior Vice President, Worldwide Retail and Marketing
Thomas J. Szkutak	42	Senior Vice President and Chief Financial Officer
Jeffrey A. Wilke	36	Senior Vice President, Worldwide Operations and Customer Service
L. Michelle Wilson	39	Senior Vice President, Human Resources, General Counsel and Secretary

Jeffrey P. Bezos. Mr. Bezos has been Chairman of the Board of Amazon.com since founding it in 1994 and Chief Executive Officer since May 1996. Mr. Bezos served as President from founding until June 1999 and again from October 2000 to the present.

Richard L. Dalzell. Mr. Dalzell has served as Senior Vice President, Worldwide Architecture and Platform Software, and Chief Information Officer since November 2001. From October 2000 until November 2001, Mr. Dalzell was Senior Vice President and Chief Information Officer and prior to that, from joining Amazon.com in August 1997 until October 2000, he was Vice President and Chief Information Officer.

Mark S. Peek. Mr. Peek has served as Vice President and Chief Accounting Officer since July 2002. From November 2000 to July 2002, he served as Vice President, Financial Planning and Analysis, and from April 2000 to November 2000, he served as Vice President, Finance and Chief Accounting Officer. Prior to joining Amazon.com, Mr. Peek was an audit partner with Deloitte & Touche.

Diego Piacentini. Mr. Piacentini has served as Senior Vice President, Worldwide Retail and Marketing, since November 2001. From joining Amazon.com in February 2000 until November 2001, Mr. Piacentini was Senior Vice President and General Manager, International. Prior to joining Amazon.com, Mr. Piacentini was Vice President and General Manager, Europe, of Apple Computer, Inc., with responsibility for Apple Computer's operations in Europe, the Middle East and Africa.

Thomas J. Szkutak. Mr. Szkutak has served as Senior Vice President and Chief Financial Officer since November 2002. Previously, Mr. Szkutak held a variety of positions at General Electric Co., including Chief Financial Officer of GE Lighting from September 2001 to September 2002, Finance Director of GE Plastics Europe from March 1999 to September 2001, and Executive Vice President — Finance of GE Asset Management (formerly known as GE Investments) from May 1997 to March 1999.

Jeffrey A. Wilke. Mr. Wilke has served as Senior Vice President, Worldwide Operations and Customer Service, since January 2002. From October 2000 until January 2002, Mr. Wilke was Senior Vice President, Operations, and prior to that he had been Vice President and General Manager, Operations, since joining Amazon.com in September 1999. Previously, Mr. Wilke held a variety of positions at AlliedSignal, including Vice President and General Manager of the Pharmaceutical Fine Chemicals unit

from March 1999 to September 1999 and General Manager of the Carbon Materials and Technologies unit from August 1997 to February 1999.

L. Michelle Wilson. Ms. Wilson has served as Senior Vice President, Human Resources, General Counsel and Secretary since March 2001. She served as Vice President, General Counsel and Secretary from July 1999 until March 2001. Ms. Wilson joined Amazon.com in March 1999 as Associate General Counsel, Mergers and Acquisitions and Finance. Prior to joining Amazon.com, she was a partner in the law firm of Perkins Coie LLP.

Board of Directors

Name	Age	Position
Jeffrey P. Bezos	39	President, Chief Executive Officer and Chairman of the Board
Tom A. Alberg	62	Managing Director of Madrona Venture Group
L. John Doerr	51	General Partner, Kleiner Perkins Caufield & Byers
Mark S. Hansen	47	Chairman and CEO of Fleming Companies, Inc.
Thomas O. Ryder	58	Chairman and CEO of Reader's Digest Association, Inc.
Patricia Q. Stonesifer	46	President and Co-Chair of the Bill & Melinda Gates Foundation

Item 2. ***Properties***

We do not own any real estate. Our principal office facilities in the U.S. are located in several leased facilities in Seattle, Washington under leases that expire at various times through July 2010. Our corporate office facilities (excluding customer service office space) in the U.S. comprise a total of 517,000 square feet. Additionally, we have 333,000 square feet of office space that is subleased or is vacant that we remain obligated under lease agreements that expire at various times through April 2011.

Our U.S. warehousing and fulfillment operations are housed in six fulfillment centers located in New Castle, Delaware; Fernley, Nevada; Coffeyville, Kansas; Lexington and Campbellsville, Kentucky; and Grand Forks, North Dakota. These fulfillment centers comprise a total of approximately 3.1 million square feet. Our fulfillment center leases expire from 2004 through 2015. We also lease six facilities located near our fulfillment centers, comprising approximately 1.1 million square feet, which we use for off-site storage and shipping. These offsite storage and shipping facilities are under relatively short-term lease agreements that expire at various times through May 2003; following expiration, we intend to renew certain of these leases or consolidate into new offsite facilities, or both.

Our U.S. customer service operations occupy approximately 76,000 square feet of office space and are located in Tacoma, Washington; Huntington, West Virginia; and Grand Forks, North Dakota. The lease terms of these facilities expire in January 2006, April 2010 and November 2008, respectively.

Our data-center facilities have 120,000 combined square feet (including approximately 40,000 square feet of vacant space at one facility). These facilities are under leases that expire from 2004 through 2009.

We lease additional properties outside the U.S., including approximately 135,000 square feet of corporate office space (excluding customer service office space) in Germany, France, Japan and the United Kingdom (which excludes approximately 40,000 square feet of vacant office space in Germany); approximately 845,000 combined square feet of available fulfillment center space in Germany, France and the United Kingdom (which excludes approximately 200,000 square feet in our United Kingdom facility that is currently subleased or marketed for sublease); and approximately 66,000 combined square feet of customer service space in Germany, Japan and the United Kingdom. The fulfillment centers in Germany,

the United Kingdom and France are located in Bad Hersfeld, Marston Gate and Orleans, respectively, and the lease terms expire in December 2009, October 2025 and March 2009, respectively.

In January 2001, we closed our fulfillment centers in McDonough, Georgia and Seattle, Washington. Our lease for the Seattle facility, which covers approximately 76,000 square feet (a portion of which is currently subleased) will expire in April 2004. We recently negotiated a termination agreement for our McDonough facility lease that accelerated the termination date to December 2002 for a portion of the building and to March 2003 for the remainder of the building (contingent on our payment of the final termination fee). At December 31, 2002, the lease for our McDonough facility covered approximately 520,000 square feet.

We believe our properties are suitable and adequate for our present and anticipated near term needs.

Item 3. ***Legal Proceedings***

On April 12, 2001, we received a request from the SEC staff for the voluntary production of documents and information concerning, among other things, previously reported sales of our common stock by our Chairman and Chief Executive Officer, Jeffrey Bezos, on February 2 and 5, 2001. We are cooperating with the SEC staff's continuing inquiry.

A number of purported class action complaints were filed by holders of our equity and debt securities against us, our directors and certain of our senior officers during 2001, in the United States District Court for the Western District of Washington, alleging violations of the Securities Act of 1933 (the "1933 Act") and/or the Securities Exchange Act of 1934 (the "1934 Act"). On October 5, 2001, plaintiffs in the 1934 Act cases filed a consolidated amended complaint alleging that we, together with certain of our officers and directors and certain third parties, made false or misleading statements during the period from October 29, 1998 through July 23, 2001 concerning our business, financial condition and results, inventories, future prospects and strategic alliance transactions. The 1933 Act complaint alleges that the defendants made false or misleading statements in connection with our February 2000 offering of the 6.875% PEACS. The complaints seek recissionary and/or compensatory damages and injunctive relief against all defendants. We dispute the allegations of wrongdoing in these complaints and intend to vigorously defend ourselves in these matters.

On August 28, 2002, the Trustee for the Creditors' Trust for Living.com instituted an adversary proceeding against a subsidiary of the Company in the United States Bankruptcy Court for the Western District of Texas. The plaintiff alleges that Living.com's creditors are entitled to a contractual recovery of approximately $58 million in fees that Living.com had previously paid in 2000 primarily by issuing Living.com stock to the Company. We dispute the plaintiff's allegations and intend to vigorously defend ourselves in this matter.

On October 29, 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 the Company 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. We dispute the plaintiff's allegations of wrongdoing 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, future results of operations, financial position or cash flows in a particular period.

From time to time, we are subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights, patents and other intellectual

property rights. We currently are not aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition or operating results.

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

No matters were submitted for a vote of our stockholders during the fourth quarter of 2002.

PART II

Item 5. *Market for the Registrant's Common Stock and Related Stockholder Matters*

Market Information

Our common stock is traded on the Nasdaq National Market under the symbol "AMZN." The following table sets forth the high and low sale prices for the common stock for the periods indicated, as reported by the Nasdaq National Market.

	High	Low
Year ended December 31, 2001		
First Quarter	$21.88	$10.00
Second Quarter	17.56	8.37
Third Quarter	16.98	5.97
Fourth Quarter	12.24	6.01
Year ended December 31, 2002		
First Quarter	$16.96	$ 9.03
Second Quarter	20.40	12.52
Third Quarter	17.93	12.26
Fourth Quarter	25.00	16.01

Holders

As of January 27, 2003, there were 4,229 stockholders of record of our common stock, although there is a much larger number of beneficial owners.

Dividends

We have never declared or paid cash dividends on our common stock. We do not anticipate paying any cash dividends in the foreseeable future. In addition, we are restricted from paying cash dividends under our Senior Discount Notes. See Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

Recent Sales of Unregistered Securities

None.

Item 6. *Selected Consolidated Financial Data*

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto in Item 8 of Part II, "Financial Statements and Supplementary Data," and the information contained herein in Item 7 of Part II, "Management's Discussion and Analysis

of Financial Condition and Results of Operations." Historical results are not necessarily indicative of future results.

	As of and for the Years Ended December 31,				
	2002	2001	2000	1999	1998(1)
	(in thousands, except per share data)				
Net sales	$ 3,932,936	$ 3,122,433	$ 2,761,983	$1,639,839	$ 609,819
Gross profit	992,618	798,558	655,777	290,645	133,664
Income (loss) from operations	64,124	(412,257)	(863,880)	(605,755)	(109,055)
Interest income	23,687	29,103	40,821	45,451	14,053
Interest expense	(142,925)	(139,232)	(130,921)	(84,566)	(26,639)
Net loss	(149,132)	(567,277)	(1,411,273)	(719,968)	(124,546)
Basic and diluted net loss per share(2)	$ (0.39)	$ (1.56)	$ (4.02)	$ (2.20)	$ (0.42)
Shares used in computation of basic and diluted net loss per share(2)	378,363	364,211	350,873	326,753	296,344
Balance Sheet Data:					
Cash and cash equivalents	$ 738,254	$ 540,282	$ 822,435	$ 133,309	$ 71,583
Marketable securities	562,715	456,303	278,087	572,879	301,862
Total assets	1,990,449	1,637,547	2,135,169	2,465,850	648,460
Long-term debt	2,277,305	2,156,133	2,127,464	1,466,338	348,140
Stockholders' Equity (Deficit)	(1,352,814)	(1,440,000)	(967,251)	266,278	138,745

(1) Reflects restatement for a 1998 business acquisition accounted for under the pooling-of-interests method.

(2) For further discussion of loss per share, see Item 8 of Part II, "Financial Statements and Supplementary Data — Note 1 — Description of Business and Accounting Policies" and "— Note 9 — Earnings (Loss) Per Share."

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

Forward-Looking Statements

This Annual Report on Form 10-K 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 industry prospects and future results of operations or financial position, made in this Annual Report on Form 10-K 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. Our actual results may differ significantly from management's expectations. The following discussion includes forward-looking statements regarding expectations of future pro forma profitability, net sales, cash flows from operations and free cash flows, all of which are inherently difficult to predict. Actual results could differ materially for a variety of reasons, including, among others, the rate of growth of the economy in general, the Internet and online commerce, customer spending patterns, the amount that we invest 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, risks of inventory management, the degree to which we enter into, maintain and develop relationships with other businesses, fluctuations in the value of securities and non-cash payments we receive in connection with such transactions, foreign exchange risks, seasonality, international growth and expansion 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 1 of Part I,