AMAZON COM INC
Form 10-Q
April 24, 2009
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

(Mark One)

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended March 31, 2009**

or

**¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to .**

**Commission File No. 000-22513**

# Amazon.com, Inc.

**(Exact Name of Registrant as Specified in its Charter)**

| **Delaware** | **91-1646860** |
|---|---|
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(I.R.S. Employer Identification No.)** |

**1200 12th Avenue South, Suite 1200, Seattle, Washington 98144-2734**

**(206) 266-1000**

**(Address and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |

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

429,647,563 shares of common stock, par value $0.01 per share, outstanding as of April 17, 2009

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**AMAZON.COM, INC.**

**FORM 10-Q**

**For the Quarterly Period Ended March 31, 2009**

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**PART I. FINANCIAL INFORMATION**

**Item 1.** ***Financial Statements***

**AMAZON.COM, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in millions)**

**(unaudited)**

| | Three Months Ended March 31, | | Twelve Months Ended March 31, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | $ 2,769 | $ 2,539 | $ 1,496 | $ 748 |
| OPERATING ACTIVITIES: | | | | |
| Net income | 177 | 143 | 679 | 508 |
| Adjustments to reconcile net income to net cash from operating activities: | | | | |
| Depreciation of fixed assets, including internal-use software and website development, and other amortization | 87 | 65 | 309 | 249 |
| Stock-based compensation | 67 | 54 | 288 | 205 |
| Other operating expense (income), net | 11 | 6 | (19) | 15 |
| Gains on sales of marketable securities, net | (2) | (3) | (1) | (3) |
| Other expense (income), net | 2 | (1) | (30) | 7 |
| Deferred income taxes | | (19) | 14 | (119) |
| Excess tax benefits from stock-based compensation | (49) | (64) | (145) | (297) |
| Changes in operating assets and liabilities: | | | | |
| Inventories | 107 | 148 | (273) | (281) |
| Accounts receivable, net and other | 167 | 139 | (190) | (182) |
| Accounts payable | (1,129) | (1,003) | 686 | 528 |
| Accrued expenses and other | (122) | (125) | 249 | 362 |
| Additions to unearned revenue | 206 | 79 | 576 | 277 |
| Amortization of previously unearned revenue | (107) | (64) | (386) | (230) |
| Net cash provided by (used in) operating activities | (585) | (645) | 1,757 | 1,039 |
| INVESTING ACTIVITIES: | | | | |
| Purchases of fixed assets, including internal-use software and website development | (55) | (61) | (326) | (251) |
| Acquisitions, net of cash acquired, and other | (15) | (355) | (155) | (430) |
| Sales and maturities of marketable securities and other investments | 314 | 271 | 1,348 | 758 |
| Purchases of marketable securities and other investments | (391) | (382) | (1,686) | (798) |
| Net cash used in investing activities | (147) | (527) | (819) | (721) |
| FINANCING ACTIVITIES: | | | | |
| Proceeds from exercises of stock options | 3 | 2 | 12 | 85 |
| Excess tax benefits from stock-based compensation | 49 | 64 | 145 | 297 |
| Common stock repurchased | | | (100) | |
| Proceeds from long-term debt and other | | 52 | 36 | 76 |
| Repayments of long-term debt and capital lease obligations | (343) | (26) | (673) | (83) |
| Net cash provided by (used in) financing activities | (291) | 92 | (580) | 375 |
| Foreign-currency effect on cash and cash equivalents | (45) | 37 | (153) | 55 |
| Net increase (decrease) in cash and cash equivalents | (1,068) | (1,043) | 205 | 748 |

| | | | | |
|---|---|---|---|---|
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 1,701 | $ 1,496 | $ 1,701 | $ 1,496 |
| | | | | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | | | |
| Cash paid for interest | $ 26 | $ 46 | $ 43 | $ 70 |
| Cash paid for income taxes | 11 | 8 | 57 | 28 |
| Fixed assets acquired under capital leases and other financing arrangements | 18 | 15 | 150 | 78 |
| Fixed assets acquired under build-to-suit leases | 56 | 4 | 125 | 19 |
| Conversion of debt | | | 605 | 1 |

See accompanying notes to consolidated financial statements.

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**AMAZON.COM, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(in millions, except per share data)**

**(unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Net sales | $ 4,889 | $ 4,135 |
| Cost of sales | 3,741 | 3,179 |
| Gross profit | 1,148 | 956 |
| Operating expenses (1): | | |
| Fulfillment | 422 | 354 |
| Marketing | 128 | 103 |
| Technology and content | 275 | 234 |
| General and administrative | 68 | 61 |
| Other operating expense, net | 11 | 6 |
| Total operating expenses | 904 | 758 |
| Income from operations | 244 | 198 |
| Interest income | 12 | 26 |
| Interest expense | (12) | (22) |
| Other income, net | 4 | 5 |
| Total non-operating income | 4 | 9 |
| Income before income taxes | 248 | 207 |
| Provision for income taxes | (69) | (62) |
| Equity-method investment activity, net of tax | (2) | (2) |
| Net income | $ 177 | $ 143 |
| Basic earnings per share | $ 0.41 | $ 0.34 |
| Diluted earnings per share | $ 0.41 | $ 0.34 |
| Weighted average shares used in computation of earnings per share: | | |
| Basic | 429 | 417 |
| Diluted | 437 | 426 |
| | | |
| (1) Includes stock-based compensation as follows: | | |
| Fulfillment | $ 15 | $ 11 |
| Marketing | 4 | 2 |
| Technology and content | 36 | 31 |
| General and administrative | 12 | 10 |

See accompanying notes to consolidated financial statements.

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**AMAZON.COM, INC.**

**CONSOLIDATED BALANCE SHEETS**

**(in millions, except per share data)**

| | March 31, 2009 (unaudited) | December 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,701 | $ 2,769 |
| Marketable securities | 1,029 | 958 |
| Inventories | 1,266 | 1,399 |
| Accounts receivable, net and other | 587 | 827 |
| Deferred tax assets | 192 | 204 |
| Total current assets | 4,775 | 6,157 |
| Fixed assets, net | 889 | 854 |
| Deferred tax assets | 118 | 145 |
| Goodwill | 433 | 438 |
| Other assets | 765 | 720 |
| Total assets | $ 6,980 | $ 8,314 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 2,380 | $ 3,594 |
| Accrued expenses and other | 1,030 | 1,152 |
| Total current liabilities | 3,410 | 4,746 |
| Long-term debt | 74 | 409 |
| Other long-term liabilities | 578 | 487 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock, $0.01 par value: | | |
| Authorized shares 500 | | |
| Issued and outstanding shares none | | |
| Common stock, $0.01 par value: | | |
| Authorized shares 5,000 | | |
| Issued shares 446 and 445 | | |
| Outstanding shares 429 and 428 | 4 | 4 |
| Treasury stock, at cost | (600) | (600) |
| Additional paid-in capital | 4,210 | 4,121 |
| Accumulated other comprehensive loss | (143) | (123) |
| Accumulated deficit | (553) | (730) |
| Total stockholders equity | 2,918 | 2,672 |
| Total liabilities and stockholders equity | $ 6,980 | $ 8,314 |

See accompanying notes to consolidated financial statements.

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**AMAZON.COM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**Note 1 Accounting Policies**

***Unaudited Interim Financial Information***

We have prepared the accompanying consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ) for interim financial reporting. These consolidated financial statements are unaudited and, in our opinion, include all adjustments, consisting of normal recurring adjustments and accruals necessary for a fair presentation of our consolidated balance sheets, operating results, and cash flows for the periods presented. Operating results for the periods presented are not necessarily indicative of the results that may be expected for 2009 due to seasonal and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our 2008 Annual Report on Form 10-K. Certain prior period amounts have been reclassified to conform to the current period presentation.

***Principles of Consolidation***

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, and those entities (relating primarily to www.amazon.cn) 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 U.S. GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, valuation of investments, receivables valuation, sales returns, incentive discount offers, inventory valuation, depreciable lives of fixed assets, internally-developed software, valuation of acquired intangibles and goodwill, income taxes, stock-based compensation, and contingencies. Actual results could differ materially from those estimates.

***Earnings per Share***

Basic earnings per share is calculated using our weighted-average outstanding common shares. Diluted earnings per share is calculated using our weighted-average outstanding common shares including the dilutive effect of stock awards as determined under the treasury stock method.

***Treasury Stock***

We account for treasury stock under the cost method and include treasury stock as a component of stockholders equity.

***Accounts Receivable, Net and Other***

Included in Accounts receivable, net and other on our consolidated balance sheets are amounts primarily related to vendor receivables and customer receivables. At March 31, 2009 and December 31, 2008, vendor receivables, net, were $238 million and $400 million, and customer receivables, net, were $223 million and $311 million.

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***Allowance for Doubtful Accounts***

We estimate losses on receivables based on known troubled accounts, if any, and historical experience of losses incurred. The allowance for doubtful customer and vendor receivables was $86 million and $81 million at March 31, 2009 and December 31, 2008.

***Internal-use Software and Website Development***

Costs incurred to develop software for internal use are required to be capitalized and amortized over the estimated useful life of the software in accordance with Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.* Costs related to design or maintenance of internal-use software are expensed as incurred. During Q1 2009 and Q1 2008, we capitalized $41 million (including $6 million of stock-based compensation) and $57 million (including $22 million acquired under business combinations and $6 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $40 million and $33 million for Q1 2009 and Q1 2008.

***Depreciation of Fixed Assets***

Fixed assets include assets such as furniture and fixtures, heavy equipment, technology infrastructure, internal-use software and website development. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets (generally two years or less for assets such as internal-use software, three years for our technology infrastructure, five years for furniture and fixtures, and ten years for heavy equipment). Depreciation expense is generally classified within the corresponding operating expense categories on our consolidated statements of operations, and certain assets are amortized as Cost of sales. Depreciation expense for fixed assets was $89 million and $71 million for Q1 2009 and Q1 2008.

***Other Assets***

Included in Other assets on our consolidated balance sheets are amounts primarily related to marketable securities restricted for longer than one year, the majority of which are attributable to collateralization of bank guarantees and debt related to our international operations; deferred costs; acquired intangible assets, net of amortization; certain equity investments; and intellectual property rights, net of amortization.

***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. The total of these investments in equity-method investees, including identifiable intangible assets, deferred tax liabilities and goodwill, is classified on our consolidated balance sheets as Other assets and our share of the investees earnings or losses along with amortization of the related intangible assets, if any, as Equity-method investment activity, net of tax on our 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 using the cost method of accounting. Under the cost method, 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 loss, a separate component of stockholders equity.

We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market funds. Such investments are included in Cash and cash equivalents or Marketable securities on the accompanying consolidated balance sheets, classified as available-for-sale and

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reported at fair value with unrealized gains and losses included in Accumulated other comprehensive 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 below their cost are other-than-temporary. This evaluation consists of several qualitative and quantitative factors regarding the severity and duration of the unrealized loss as well as our ability and intent to hold the investment until a forecasted recovery occurs. Factors considered include quoted market prices; recent financial results and operating trends; other publicly available information; implied values from any recent transactions or offers of investee securities; or other conditions that may affect the value of our investments.

***Accrued Expenses and Other***

Included in Accrued expenses and other at March 31, 2009 and December 31, 2008 were liabilities of $242 million and $270 million for unredeemed gift certificates. We recognize revenue from a gift certificate when a customer redeems it. If a gift certificate is not redeemed, we recognize revenue when it expires or, for a certificate without an expiration date, when the likelihood of its redemption becomes remote, generally two years from date of issuance.

***Unearned Revenue***

Unearned revenue is recorded when payments are received in advance of performing our service obligations and is recognized over the service period. Current unearned revenue is included in Accrued expenses and other and non-current unearned revenue is included in Other long-term liabilities on our consolidated balance sheets. Current unearned revenue was $255 million and $191 million at March 31, 2009 and December 31, 2008. Non-current unearned revenue was $80 million and $46 million at March 31, 2009 and December 31, 2008.

***Income Taxes***

Income tax expense includes U.S. and international income taxes. We do not provide for U.S. taxes on our undistributed earnings of foreign subsidiaries since we intend to invest such undistributed earnings indefinitely outside of the U.S. Determination of the unrecognized deferred tax liability that would be incurred if such amounts were repatriated is not practicable.

Under Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes,* 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.

SFAS No. 109 requires that deferred tax assets be evaluated for future realization and be reduced by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience and expectations of future taxable income by taxing jurisdiction, the carry-forward periods available to us for tax reporting purposes, and other relevant factors. In accordance with SFAS No. 109, we allocate our valuation allowance to current and long-term deferred tax assets on a pro-rata basis.

Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* requires a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies) accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and

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estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. Our policy is to include interest and penalties related to our tax contingencies in income tax expense.

***Fair Value of Financial Instruments***

Effective January 1, 2008, we adopted SFAS No. 157, *Fair Value Measurements*, except as it applied to the nonfinancial assets and nonfinancial liabilities subject to the FASB issued Staff Position (FSP) No. 157-2, which we adopted effective January 1, 2009. SFAS No. 157 clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value, and expands disclosures about fair value measurements. The three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies, is:

**Level 1** Valuations based on quoted prices for identical assets and liabilities in active markets.

**Level 2** Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

**Level 3** Valuations based on unobservable inputs reflecting our own assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

***Shipping Activities***

Outbound shipping charges to customers are included in Net sales and were $190 million and $192 million for Q1 2009 and Q1 2008. Outbound shipping-related costs are included in Cost of sales and totaled $358 million and $320 million for Q1 2009 and Q1 2008. The net cost to us of shipping activities was $168 million and $128 million for Q1 2009 and Q1 2008.

***Stock-Based Compensation***

SFAS No. 123(R), *Share-Based Payment*, requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The fair value of restricted stock and restricted stock units is determined based on the number of shares granted and the quoted price of our common stock. Such value is recognized as expense over the service period, net of estimated forfeitures, using the accelerated method. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results and future estimates may differ substantially from our current estimates.

***Recent Accounting Pronouncements***

In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 was effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, FSP No. 157-2 delayed the effective date of SFAS No. 157 one year for all nonfinancial assets and nonfinancial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis.

Those assets and liabilities measured at fair value under SFAS No. 157 in Q1 2008 did not have a material impact on our consolidated financial statements. The adoption of FSP 157-2 for nonfinancial assets and liabilities in Q1 2009 did not have a material impact on our consolidated financial statements.

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In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements.* SFAS No. 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquired entity at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 will impact acquisitions closed on or after January 1, 2009. Adoption did not have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. We adopted FSP No. 142-3 as of January 1, 2009. Adoption did not have a material impact on our consolidated financial statements.

In June 2008, the FASB ratified the consensus reached on Emerging Issues Task Force (EITF) Issue No. 07-05, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock*. EITF Issue No. 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity s own stock, which would qualify as a scope exception under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. We adopted EITF Issue No. 07-05 as of January 1, 2009. Adoption did not have a material impact on our consolidated financial statements.

**Note 2 Cash, Cash Equivalents, and Marketable Securities**

As of March 31, 2009 and December 31, 2008 our cash, cash equivalents, and marketable securities primarily consisted of cash, government and government agency securities, AAA-rated money market funds, and other investment grade securities. Such amounts are recorded at fair value. The following table summarizes, by major security type, our cash, cash equivalents, and marketable securities (in millions):

| | March 31, 2009 | | | |
|---|---|---|---|---|
| | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses (1) | Total Estimated Fair Value |
| Cash | $ 241 | $ | $ | $ 241 |
| Money market funds | 1,397 | | | 1,397 |
| Foreign government and agency securities | 826 | 8 | | 834 |
| Corporate debt securities (2) | 153 | 2 | (2) | 153 |
| U.S. government and agency securities | 315 | 6 | | 321 |
| Asset-backed securities | 58 | 1 | (3) | 56 |
| Other fixed income securities | 22 | | | 22 |
| Equity securities | 2 | | (1) | 1 |
| | $ 3,014 | $ 17 | $ (6) | $ 3,025 |
| Less: Long-term marketable securities (3) | | | | (295) |
| Total cash, cash equivalents, and marketable securities | | | | $ 2,730 |

(1) As of March 31, 2009, the cost and fair value of investments with loss positions was $360 million and $354 million. We evaluated the nature of these investments, credit worthiness of the issuer and the duration of these impairments to determine if an other-than-temporary decline in fair value had occurred and concluded that these losses were temporary. Investments that have continuously been in loss positions for more than twelve months have gross unrealized losses of $2 million.

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(2) Corporate debt securities include investments in financial, insurance, and corporate institutions. No single issuer represents a significant portion of the total corporate debt securities portfolio.

(3) We are required to pledge or otherwise restrict a portion of our marketable securities as collateral for standby letters of credit, guarantees, debt and real estate lease agreements. We classify cash and marketable securities with use restrictions of twelve months or longer as non-current Other assets on our consolidated balance sheets. See Note 4 Commitments and Contingencies.

Gross gains of $6 million and $4 million and gross losses of $4 million and $1 million were realized on sales of available-for-sale marketable securities, including Euro-denominated securities, for Q1 2009 and Q1 2008. Realized gains and losses are included in Other income, net on our consolidated statements of operations.

The following table summarizes, by major security type, our assets that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy (in millions):

| | March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Cash | Level 1 Estimated Fair Value | Level 2 Estimated Fair Value | Level 3 Estimated Fair Value | Total Estimated Fair Value |
| Cash | $ 241 | $ | $ | $ | $ 241 |
| Money market funds | | 1,397 | | | 1,397 |
| Foreign government and agency securities | | | 834 | | 834 |
| Corporate debt securities | | | 153 | | 153 |
| U.S. government and agency securities | | | 321 | | 321 |
| Asset-backed securities | | | 56 | | 56 |
| Other fixed income securities | | | 22 | | 22 |
| Equity securities | | 1 | | | 1 |
| | $ 241 | $ 1,398 | $ 1,386 | $ | $ 3,025 |

| | December 31, 2008 | | | | |
|---|---|---|---|---|---|
| | Cash | Level 1 Estimated Fair Value | Level 2 Estimated Fair Value | Level 3 Estimated Fair Value | Total Estimated Fair Value |
| Cash | $ 355 | $ | $ | $ | $ 355 |
| Money market funds | | 1,682 | | | 1,682 |
| Foreign government and agency securities | | | 1,128 | | 1,128 |
| Corporate debt securities | | | 194 | | 194 |
| U.S. government and agency securities | | | 594 | | 594 |
| Asset-backed securities | | | 58 | | 58 |
| Other fixed income securities | | | 23 | | 23 |
| Equity securities | | 1 | | | 1 |
| | $ 355 | $ 1,683 | $ 1,997 | $ | $ 4,035 |

**Note 3 Long-Term Debt**

In February 2008, our Board of Directors authorized a debt repurchase program, pursuant to which in Q1 2009 we redeemed the remaining 240 million ($319 million based on the Euro to U.S. Dollar exchange rate on the date of redemption) in principal of our 6.875% PEACS.

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**Note 4 Commitments and Contingencies**

***Commitments***

We lease office and fulfillment center facilities and fixed assets under non-cancelable operating and capital leases. Rental expense under operating lease agreements was $41 million and $39 million for Q1 2009 and Q1 2008.

In December 2007, we entered into a series of leases and other agreements for the lease of corporate office space to be developed in Seattle, Washington with initial terms of up to 16 years commencing on completion of development in 2010 and 2011 and options to extend for two five-year periods. At March 31, 2009, under the agreements we committed to occupy approximately 1,370,000 square feet of office space. In addition, we have the right to occupy up to an additional approximately 330,000 square feet subject to a termination fee, estimated to be up to approximately $10 million, if we elect not to occupy the additional space. We also have an option to lease up to an additional approximately 500,000 square feet at rates based on fair market values at the time the option is exercised, subject to certain conditions. In addition, if interest rates exceed a certain threshold, we have the option to provide financing for some of the buildings.

The following summarizes our principal contractual commitments, excluding open orders for inventory purchases that support normal operations, as of March 31, 2009:

| | Nine Months Ended December 31, 2009 | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|---|
| | | 2010 | 2011 | 2012 | 2013 | Thereafter | Total |
| | | | | (in millions) | | | |
| Operating and capital commitments: | | | | | | | |
| Debt principal | $ 59 | $ | $ 41 | $ 33 | $ | $ | $ 133 |
| Debt interest | 6 | 6 | 5 | 1 | | | 18 |
| Capital leases, including interest | 68 | 82 | 49 | 8 | 4 | 1 | 212 |
| Operating leases | 109 | 133 | 111 | 99 | 90 | 304 | 846 |
| Other commitments (1) (2) | 61 | 177 | 100 | 82 | 76 | 1,065 | 1,561 |
| Total commitments | $ 303 | $ 398 | $ 306 | $ 223 | $ 170 | $ 1,370 | $ 2,770 |

(1) Includes the estimated timing and amounts of payments for rent, operating expenses, and tenant improvements associated with approximately 1,370,000 square feet of corporate office space being developed in Seattle, Washington and also includes the $10 million termination fee related to our right to occupy up to an additional approximately 330,000 square feet. The amount of space available and our financial and other obligations under the lease agreements are affected by various factors, including government approvals and permits, interest rates, development costs and other expenses and our exercise of certain rights under the lease agreements.

(2) Excludes $174 million of tax contingencies for which we cannot make a reasonably reliable estimate of the amount and period of payment, if at all. See Note 1 Accounting Policies Income Taxes.

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***Pledged Securities***

We are required to pledge or otherwise restrict a portion of our cash and marketable securities as collateral for standby letters of credit, guarantees, debt and real estate leases. We classify cash and marketable securities with use restrictions of twelve months or longer as non-current Other assets on our consolidated balance sheets. The balance of pledged securities at March 31, 2009 consisted of $7 million in Marketable securities and $295 million included in Other assets. The amount required to be pledged for certain real estate lease agreements changes over the life of our leases based on our credit rating and changes in our market capitalization (common shares outstanding multiplied by the closing price of our common stock). Information about collateral required to be pledged under these agreements is as follows:

| | Standby and Trade Letters of Credit and Guarantees | Debt (1) | Real Estate Leases (2) | Total |
|---|---|---|---|---|
| | | (in millions) | | |
| Balance at December 31, 2008 | $ 138 | $ 160 | $ 10 | $ 308 |
| Net change in collateral pledged | (2) | | (4) | (6) |
| Balance at March 31, 2009 | $ 136 | $ 160 | $ 6 | $ 302 |

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

(2) At March 31, 2009, our market capitalization was $31.5 billion. The required amount of collateral to be pledged will increase by $5 million if our market capitalization is equal to or below $18 billion and by an additional $6 million if our market capitalization is equal to or below $13 billion.

***Legal Proceedings***

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

In June 2001, Audible, Inc., our subsidiary acquired in March 2008, was named as a defendant in a securities class-action filed in United States District Court for the Southern District of New York related to its initial public offering in July 1999. The lawsuit also named certain of the offering s underwriters, as well as Audible s officers and directors as defendants. Approximately 300 other issuers and their underwriters have had similar suits filed against them, all of which are included in a single coordinated proceeding in the Southern District of New York. The complaints allege that the prospectus and the registration statement for Audible s offering failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some investors allegedly agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of the Company s stock. Audible and its officers and directors were named in the suits pursuant to Section 11 of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and other related provisions. The complaints seek unspecified damages, attorney and expert fees, and other unspecified litigation costs. In March 2009, all parties, including Audible, reached a settlement of these class actions that would resolve this dispute entirely with no payment required from Audible. The settlement is still subject to review and approval by the Court.

Beginning in March 2003, we were served with complaints filed in several different states, including Illinois, by a private litigant, Beeler, Schad & Diamond, P.C., 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. In December 2006, we learned that one additional complaint was filed in the state of Illinois by a different private litigant, Matthew T. Hurst, alleging similar violations of the Illinois state law. All of 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

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that we have been or will be named in similar cases in other states as well. We dispute the allegations of wrongdoing in these complaints and intend to vigorously defend ourselves in these matters.

In May 2004, Toysrus.com LLC filed a complaint against us for breach of contract in the Superior Court of New Jersey. The complaint alleged that we breached our commercial agreement with Toysrus.com LLC by selling, and by permitting other third parties to sell, products that Toysrus.com LLC alleged it has an exclusive right to sell on our website. We disputed the allegations in the complaint and brought counterclaims alleging breach of contract and seeking damages and declaratory relief. In March 2006, the Court entered a judgment in favor of Toysrus.com LLC, terminating the contract but declining to award damages to either party. In March 2009, the Appellate Division of the New Jersey Superior Court affirmed the trial court s rulings in Toysrus.com LLC s favor and reversed the trial court s ruling on damages, remanding the case to the trial court for further proceedings on Toysrus.com LLC s claim that it is entitled to damages. Toysrus.com has moved the trial court for damages of approximately $93 million (including pre- and post-judgment interest). We believe, based on the evidence at trial, that Toysrus.com LLC s damage claim is grossly overstated. We are also seeking leave to appeal the Appellate Division s decision to the New Jersey Supreme Court.

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

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

In October 2007, Digital Reg of Texas, LLC filed a complaint against our subsidiary, Audible, Inc., and several other defendants in the United States District Court for the Eastern District of Texas. The complaint alleges that Audible s digital rights management technology infringes a patent obtained by Digital Reg purporting to cover a system for Regulating Access to Digital Content (U.S. Patent No. 6,389,541) and seeks injunctive relief, monetary damages, enhanced damages for alleged willful infringement, prejudgment and post-judgment interest, costs and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in the matter.

In December 2008, Quito Enterprises, LLC filed a complaint against us for patent infringement in the United States District Court for the Southern District of Florida. The complaint alleges that our website technology infringes a patent obtained by Quito purporting to cover a Personal Feedback Browser for Obtaining Media Files (U.S. Patent No. 5,890,152) and seeks injunctive relief and monetary damages. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In January 2009, we learned that the United States Postal Service, including the Postal Service Office of Inspector General, is investigating our compliance with Postal Service rules, and we are cooperating.

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In March 2009, Discovery Communications, 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 Kindle and Kindle 2 wireless reading devices infringe a patent owned by Discovery purporting to cover an Electronic Book Security and Copyright Protection System (U.S. Patent No. 7,298,851) and seeks monetary damages, a continuing royalty sufficient to compensate Discovery for any future infringement, treble damages, costs and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In March 2009, the Tobin Family Education and Health Foundation filed a complaint against us for patent infringement in the United States District Court for the Middle District of Florida. The complaint alleges, among other things, that the technology underlying the Amazon Associates program infringes a patent owned by Tobin purporting to cover a Method and System for Customizing Marketing Services on Networks Communication with Hypertext Tagging Conventions (U.S. Patent No. 7,505,913) and seeks injunctive relief, monetary damages, costs and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In March 2009, TQP Development LLC filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that our website technology infringes a patent owned by TQP purporting to cover an Encrypted Data Transmission System Employing Means for Randomly Altering the Encryption Keys (U.S. Patent No. 5,412,730) and seeks injunctive relief, monetary damages, treble damages, costs and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In April 2009, Parallel Networks, LLC filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that our website technology infringes a patent owned by Parallel Networks purporting to cover a Method And Apparatus For Client-Server Communication Using a Limited Capability Client Over A Low-Speed Communications Link (U.S. Patent No. 6,446,111) and seeks injunctive relief, monetary damages, costs and attorneys fees. We dispute the 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, results of operations, financial position, or cash flows.

See also Note 8 Income Taxes.

**Note 5 Stockholders Equity**

***Stock Award Activity***

We granted stock awards, which consist primarily of restricted stock units, representing 0.6 and 1.0 million shares of common stock during Q1 2009 and Q1 2008 with a per share weighted average fair value of $58.74 and $74.72. Our annual stock awards are granted in the second quarter.

Common shares underlying outstanding stock awards were as follows:

| | March 31, 2009 | December 31, 2008 |
|---|---|---|
| | (in millions) | |
| Restricted stock units | 16.1 | 16.7 |
| Stock options (1) | 1.1 | 1.2 |
| Total outstanding stock awards | 17.2 | 17.9 |

(1) The weighted average per share exercise price was $23.12 and $25.44 at March 31, 2009 and December 31, 2008.

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Common shares outstanding plus shares underlying outstanding stock options and restricted stock units totaled 447 million and 446 million at March 31, 2009 and December 31, 2008. These totals include all stock-based awards outstanding, without regard for estimated forfeitures, consisting of vested and unvested awards, and in-the-money and out-of-the-money stock options.

The following table summarizes our restricted stock unit activity for the three months ended March 31, 2009 (in millions):

| | Number of Units |
|---|---|
| Outstanding at December 31, 2008 | 16.7 |
| Units granted | 0.6 |
| Units vested | (1.0) |
| Units cancelled | (0.2) |
| Outstanding at March 31, 2009 | 16.1 |

Scheduled vesting for outstanding restricted stock units at March 31, 2009 is as follows (in millions):

| | Nine Months Ended December 31, 2009 | Year Ended December 31, 2010 | 2011 | 2012 | 2013 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Scheduled vesting restricted stock units | 5.0 | 5.3 | 3.0 | 1.8 | 0.7 | 0.3 | 16.1 |

As of March 31, 2009, there was $327 million of net unrecognized compensation cost related to unvested stock-based compensation arrangements. This compensation is recognized on an accelerated basis resulting in approximately half of the compensation expected to be expensed in the next twelve months and has a weighted average recognition period of 1.2 years.

**Note 6 Comprehensive Income**

Comprehensive income was $157 million and $145 million for Q1 2009 and Q1 2008. The primary differences between net income as reported and comprehensive income are foreign currency translation adjustments, net of tax, and changes in unrealized gains and losses on available-for-sale securities, net of tax.

**Note 7 Other Income, Net**

Other income, net, was $4 million in Q1 2009 and $5 million in Q1 2008, and consisted primarily of gains and losses on sales of marketable securities, foreign currency transaction gains and losses, and other miscellaneous losses.

**Note 8 Income Taxes**

Our tax provision for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes we make a cumulative adjustment. The 2009 annual effective tax rate is estimated to be lower than the 35% U.S. federal statutory rate primarily due to anticipated earnings of our subsidiaries outside of the U.S. in jurisdictions where our effective tax rate is lower than in the U.S. Cash paid for income taxes was $11 million and $8 million in Q1 2009 and Q1 2008.

As of March 31, 2009 and December 31, 2008, tax contingencies were $174 million and $166 million. Due to the nature of our business operations we expect the total amount of tax contingences for prior period tax positions will grow over the next 12 months in comparable amounts to the prior 12 months. We do not believe it is reasonably possible that the total amount of unrecognized tax benefits will significantly decrease within the next 12 months.

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We are under examination, or may be subject to examination, by the Internal Revenue Service ( IRS ) for calendar years 2005 through 2008. Additionally, any net operating losses that were generated in prior years and utilized in 2005 through 2008 may also be subject to examination by the IRS. We are under examination, or may be subject to examination, in the following major jurisdictions for the years specified: Kentucky for 2004 through 2008, France for 2006 through 2008, Germany for 2003 through 2008, Luxembourg for 2004 through 2008, and the United Kingdom for 2003 through 2008. In addition, in 2007, Japanese tax authorities assessed income tax, including penalties and interest, of approximately $110 million against one of our U.S. subsidiaries for the years 2003 through 2005. We believe that these claims are without merit and are disputing the assessment. Further proceedings on the assessment will be stayed during negotiations between U.S. and Japanese authorities over the double taxation issues the assessment raises, and we have provided bank guarantees to suspend enforcement of the assessment. We also may be subject to income tax examination by Japanese tax authorities for 2006 through 2008.

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**Note 9 Segment Information**

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

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

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2009 | 2008 |
| | (in millions) | |
| **North America** | | |
| Net sales | $ 2,578 | $ 2,126 |
| Cost of sales | 1,884 | 1,557 |
| Gross profit | 694 | 569 |
| Direct segment operating expenses | 544 | 439 |
| Segment operating income | $ 150 | $ 130 |
| **International** | | |
| Net sales | $ 2,311 | $ 2,009 |
| Cost of sales | 1,857 | 1,622 |
| Gross profit | 454 | 387 |
| Direct segment operating expenses | 282 | 259 |
| Segment operating income | $ 172 | $ 128 |
| **Consolidated** | | |
| Net sales | $ 4,889 | $ 4,135 |
| Cost of sales | 3,741 | 3,179 |
| Gross profit | 1,148 | 956 |
| Direct segment operating expenses | 826 | 698 |
| Segment operating income | 322 | 258 |
| Stock-based compensation | (67) | (54) |
| Other operating expense, net | (11) | (6) |
| Income from operations | 244 | 198 |
| Total non-operating income, net | 4 | 9 |
| Provision for income taxes | (69) | (62) |
| Equity-method investment activity, net of tax | (2) | (2) |
| Net income | $ 177 | $ 143 |

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

**Forward-Looking Statements**

*This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding guidance, industry prospects or future results of operations or financial position, made in this Quarterly Report on Form 10-Q are forward-looking. We use words such as anticipates, believes, expects, future, intends, and similar expressions to identify forward-looking statements. Forward-looking statements reflect management s current expectations and are inherently uncertain. Actual results could differ materially for a variety of reasons, including, among others, fluctuations in foreign exchange rates, changes in global economic conditions and consumer spending, world events, the rate of growth of the Internet and online commerce, the amount that Amazon.com invests in new business opportunities and the timing of those investments, the mix of products sold to customers, the mix of net sales derived from products as compared with services, the extent to which we owe income taxes, competition, management of growth, potential fluctuations in operating results, international growth and expansion, the outcomes of legal proceedings and claims, fulfillment center optimization, risks of inventory management, seasonality, the degree to which the Company enters into, maintains, and develops commercial agreements, acquisitions, and strategic transactions, payments risks, and risks of fulfillment throughput and productivity. In addition, the current global economic climate amplifies many of these risks. These risks and uncertainties, as well as other risks and uncertainties that could cause our actual results to differ significantly from management s expectations, are described in greater detail in Item 1A of Part II, Risk Factors.*

For additional information, see Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations Overview of our 2008 Annual Report on Form 10-K.

**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, of our 2008 Annual Report on Form 10-K. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions.

***Revenue Recognition***

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

We evaluate the criteria of EITF 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

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the net amount earned as commissions. Generally, when we are the primary party obligated in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not primarily obligated and amounts earned are determined using a percentage, a fixed-payment schedule, or a combination of the two, we generally record the net amounts as commissions earned.

Product sales and shipping revenues, net of promotional discounts, rebates and return allowances, are recorded when the products are shipped and title passes to customers. Retail items sold to customers are made pursuant to sales contracts that generally provide for transfer of both title and risk of loss upon our delivery to the carrier. Return allowances, which reduce product revenue by our best estimate of expected product returns, are estimated using historical experience. Revenue from product sales and services rendered is recorded net of sales taxes. Amounts paid in advance for subscription services, including amounts received for Amazon Prime and other membership programs, are deferred and recognized as revenue over the subscription term. For our products with multiple elements, where a standalone value for each element cannot be established, we recognize the revenue and related cost over the estimated economic life of the product.

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

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

***Inventories***

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

We provide fulfillment-related services in connection with certain of our agreements. In those arrangements, as well as other product sales by other sellers, the seller maintains ownership of the related products. As such, these amounts are not included in our consolidated balance sheets.

***Investments***

We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market funds. We also have equity-method investments in private companies where we can exercise significant influence over, but not control, the entity. We periodically evaluate whether declines in fair values of our investments are other-than-temporary. This evaluation consists of several qualitative and quantitative factors regarding the severity and duration of the unrealized loss as well as our ability and intent to hold the investment. Factors considered include, if applicable, quoted market prices; recent financial results and operating trends; other publicly available information; implied values from any recent transactions or offers of investee securities; or other conditions that may affect the value of our investments.

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***Goodwill***

We evaluate goodwill for impairment annually and when an event occurs or circumstances change to suggest that the carrying value may not be recoverable. Our annual testing date is October 1. We test goodwill for impairment by first comparing the book value of net assets to the fair value of the related operations. If the fair value is determined to be less than book value, a second step is performed to compute the amount of impairment. We estimate fair value using discounted cash flows of reporting units. Forecasts of future cash flow are based on our best estimate of future net sales and operating expenses, based primarily on projected category expansion, pricing expectations, market segment penetration and general economic conditions. Additionally, certain estimates of discounted cash flows involve businesses and geographies with limited financial history and developing revenue models. In this process, a fair value for goodwill is estimated and compared to its carrying value. The shortfall of the fair value below carrying value represents the amount of goodwill impairment. Changes in these forecasts could significantly change the amount of impairment recorded, if any.

The financial and credit market volatility directly impacts our fair value measurement through our weighted average cost of capital that we use to determine our discount rate and through our stock price that we use to determine our market capitalization. During times of volatility, significant judgment must be applied to determine whether credit or stock price changes are a short term swing or a longer-term trend.

***Internal-Use Software and Website Development***

Included in fixed assets is the capitalized cost of internal-use software and website development, including software used to upgrade and enhance our websites and processes supporting our business. As required by 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 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.

***Stock-Based Compensation***

We measure compensation cost for stock awards at fair value and recognize compensation over the service period for awards expected to vest. The fair value of restricted stock and restricted stock units is determined based on the number of shares granted and the quoted price of our common stock. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results and future estimates may differ substantially from our current estimates.

We utilize the accelerated method, rather than a straight-line method, for recognizing compensation expense. Under this method, over 50% of the compensation cost would be expensed in the first year of a four year vesting term. The accelerated method also adds a higher level of sensitivity and complexity in estimating forfeitures. If forfeited early in the life of an award, the forfeited amount is much greater under an accelerated method than under a straight-line method.

***Income Taxes***

We are subject to income taxes in both the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves for tax contingencies are established when we believe that certain positions might be challenged despite our belief that our tax return positions are fully supportable. We

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adjust these reserves in light of changing facts and circumstances, such as the outcome of tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate.

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. The majority of our gross deferred tax assets relate to net operating loss carryforwards attributable to differences in stock-based compensation between the financial statements and our tax returns.

SFAS No. 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 and expectations of future taxable income by taxing jurisdiction, the carry-forward periods available to us for tax reporting purposes, and other relevant factors. In accordance with the provisions of SFAS No. 109, we allocate our valuation allowance to current and long-term deferred tax assets on a pro-rata basis.

If we determine that additional portions of our deferred tax assets are realizable, the majority of the benefit will come from the assets associated with the stock-based compensation that was not recognized in the financial statements, but was claimed on the tax return. Since this compensation did not originally run through our consolidated statements of operations, the benefit generated will be recorded to stockholders equity.

FIN No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109,* requires a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies) accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes.

***Recent Accounting Pronouncements***

See Item 1 of Part I, Financial Statements Note 1 Accounting Policies Recent Accounting Pronouncements.

**Liquidity and Capital Resources**

Cash flow information is as follows:

| | Three Months Ended March 31, | | Twelve Months Ended March 31, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| | (in millions) | | (in millions) | |
| Operating activities | $ (585) | $ (645) | $ 1,757 | $ 1,039 |
| Investing activities | (147) | (527) | (819) | (721) |
| Financing activities | (291) | 92 | (580) | 375 |

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Our financial focus is on long-term, sustainable growth in free cash flow[1]. Free cash flow, a non-GAAP financial measure, was $1.43 billion for the trailing twelve months ended March 31, 2009, compared to $788 million for the trailing twelve months ended March 31, 2008, an increase of 82%. See Non-GAAP Financial Measures below for a reconciliation of free cash flow to cash provided by operating activities. The increase in free cash flow for the trailing twelve months ended March 31, 2009 compared to the comparable prior year period was due to increased operating income, decreased tax benefits on excess stock-based compensation deductions, changes in working capital and increased deferred revenue. SFAS 123 (R) requires tax benefits relating to excess stock-based compensation deductions to be presented in the statement of cash flows as financing cash inflows; accordingly, as such tax benefits decline, a greater amount of cash is classified as operating cash inflow. Operating cash flows and free cash flows can be volatile and are sensitive to many factors, including changes in working capital and the timing and magnitude of capital expenditures. Working capital at any specific point in time is subject to many variables, including seasonality, inventory management and category expansion, the timing of cash receipts and payments, vendor payment terms, valuation of cash equivalents and marketable securities, and fluctuations in foreign exchange rates.

Our principal sources of liquidity are cash flows generated from operations and our cash, cash equivalents, and marketable securities balances, which, at fair value, were $2.7 billion and $3.7 billion at March 31, 2009 and December 31, 2008. Amounts held in foreign currencies were $1.2 billion and $1.7 billion at March 31, 2009 and December 31, 2008, and were primarily Euros, British Pounds, and Japanese Yen. See Item 1 of Part I, Financial Statements Note 1 Accounting Policies Income Taxes.

Cash used in operating activities was $585 million and $645 million for Q1 2009 and Q1 2008. Our operating cash flows result primarily from cash received from our customers, from sellers, and from non-retail activities such as other seller services, miscellaneous marketing and promotional agreements, our co-branded credit card agreements and Amazon Web Services, offset by cash payments we make for products and services, employee compensation (less amounts capitalized pursuant to SOP 98-1 that are reflected as cash used in investing activities), payment processing and related transaction costs, operating leases, and interest payments on our long-term debt obligations. Cash received from customers, sellers, developers, and other activities generally corresponds to our net sales. Because our customers primarily use credit cards to buy from us, our receivables from customers settle quickly.

Cash provided by (used in) investing activities corresponds with purchases, sales, and maturities of marketable securities, cash outlays for acquisitions, equity-method investments and intellectual property rights, and purchases of fixed assets, including internal-use software and website development costs. Cash used in investing activities was $147 million and $527 million for Q1 2009 and Q1 2008, with the variability caused primarily by decreased acquisition activity in Q1 2009. Capital expenditures were $55 million and $61 million during Q1 2009 and Q1 2008. Capital expenditures included $34 million and $29 million for internal-use software and website development during Q1 2009 and Q1 2008. Stock-based compensation capitalized for internal-use software and website development costs does not affect cash flows. During the three months ended March 31, 2009 and 2008, we made cash payments, net of acquired cash, related to acquisition and investment activity of $15 million and $355 million.

Cash provided by (used in) financing activities was $(291) million and $92 million for Q1 2009 and Q1 2008. Cash outflows from financing activities result from repayments of long-term debt and payments on capital lease obligations. Repayments on long-term debt and payments on capital lease obligations were $343 million and $26 million in Q1 2009 and Q1 2008. Cash inflows from financing activities primarily result from proceeds

from tax benefits relating to excess stock-based compensation deductions. SFAS No. 123(R) requires tax benefits

[1] Free cash flow, a non-GAAP financial measure, is defined as net cash provided by operating activities less purchases of fixed assets, including capitalized internal-use software and website development, both of which are presented on our consolidated statements of cash flows. See Non-GAAP Financial Measures below.

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relating to excess stock-based compensation deductions be presented as financing cash flows. Cash inflows from tax benefits related to stock-based compensation deductions were $49 million and $64 million for Q1 2009 and Q1 2008.

In Q1 2009 and Q1 2008, we recorded a net tax provision of $69 million and $62 million. A majority of this provision is non-cash. We have current tax benefits and net operating losses relating to excess stock-based compensation deductions that are being utilized to reduce our U.S. taxable income. As such, cash taxes paid were $11 million and $8 million for Q1 2009 and Q1 2008. As our federal and state net operating losses and tax credits are utilized, cash paid for taxes will increase. We endeavor to optimize our global taxes on a cash basis, rather than on a financial reporting basis.

In February 2008, our Board of Directors authorized a debt repurchase program, pursuant to which in Q1 2009 we redeemed the remaining 240 million ($319 million based on the Euro to U.S. Dollar exchange rate on the date of redemption) in principal of our 6.875% PEACS.

In February 2008, our Board of Directors authorized a 24-month program to repurchase up to $1 billion of our common stock, pursuant to which we repurchased $100 million of our common stock in 2008. See Item 1 of Part I, Financial Statements Note 4 Commitments and Contingencies for additional discussion of our principal contractual commitments, as well as our pledged securities. Purchase obligations and open purchase orders, consisting of inventory and significant non-inventory commitments, were $630 million at March 31, 2009.

On average, our high inventory velocity means we collect from our customers before our payments to suppliers come due. Inventory turnover[2] was 13 for both Q1 2009 and Q1 2008. Inventory turnover has declined slightly over the last several years, primarily due to category expansion and changes in product mix, and our continuing focus on in-stock inventory availability, which enables faster delivery of products to our customers. We expect some variability in inventory turnover over time as it is affected by several factors, including our product mix, the mix of sales by us and by other sellers, our continuing focus on in-stock inventory availability, our investment in new geographies and product lines, and the extent to which we choose to utilize outsource fulfillment providers.

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

**Results of Operations**

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

[2] Inventory turnover is the quotient of trailing twelve month cost of sales to average inventory over five quarter ends.

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***Net Sales and Gross Profit***

Net sales information is as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2009 | 2008 |
| | (in millions) | |
| Net Sales: | | |
| North America | $ 2,578 | $ 2,126 |
| International | 2,311 | 2,009 |
| Consolidated | $ 4,889 | $ 4,135 |
| Year-over-year Percentage Growth: | | |
| North America | 21% | 31% |
| International | 15 | 44 |
| Consolidated | 18 | 37 |
| Year-over-year Percentage Growth, excluding effect of exchange rates: | | |
| North America | 22% | 31% |
| International | 28 | 31 |
| Consolidated | 25 | 31 |
| Net Sales Mix: | | |
| North America | 53% | 51% |
| International | 47 | 49 |
| Consolidated | 100% | 100% |

Revenue increased 18% in Q1 2009, reflecting revenue growth in both our North America and International segments. Additionally, changes in currency exchange rates negatively affected net sales by $268 million for Q1 2009. For a discussion of the effect on revenue growth of exchange rates, see Effect of Exchange Rates below.

The North America revenue growth rate was 21% for Q1 2009. This revenue growth primarily reflects increased unit sales driven largely by our continued efforts to reduce prices for our customers, including from our free shipping offers and Amazon Prime, and by increased in-stock inventory availability and increased selection of product offerings, as well as a larger base of sales in faster growing categories such as electronics and other general merchandise.

The International revenue growth rate was 15% for Q1 2009. This revenue growth primarily reflects increased unit sales driven largely by our continued efforts to reduce prices for our customers, including from our free shipping offers and Amazon Prime, and by increased in-stock inventory availability and increased selection of product offerings, as well as a larger base of sales in faster growing categories such as electronics and other general merchandise. Additionally, changes in currency exchange rates negatively affected International net sales by $258 million for Q1 2009.

We expect that, over time, our International segment will represent 50% or more of our consolidated net sales. Additionally, as we continue to offer increased selection, lower prices, and additional product lines within our electronics and other general merchandise category, we expect to see the relative mix of sales from this category increase. See Supplemental Information below.

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Gross profit information is as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2009 | 2008 |
| | (in millions) | |
| Gross Profit: | | |
| North America | $ 694 | $ 569 |
| International | 454 | 387 |
| Consolidated | $ 1,148 | $ 956 |
| Gross Profit Growth Rate: | | |
| North America | 22% | 29% |
| International | 17 | 38 |
| Consolidated | 20 | 33 |
| Gross Margin: | | |
| North America | 26.9% | 26.7% |
| International | 19.6 | 19.3 |
| Consolidated | 23.5 | 23.1 |

The increase in gross profit in absolute terms during Q1 2009 compared with the comparable prior year period corresponds with increases in sales, offset by lower prices for customers including from free shipping offers and Amazon Prime. Generally, our gross margins fluctuate based on several factors, including our product, service, and geographic mix of sales; sales by other sellers; changes in vendor pricing, including the extent to which we receive discounts and allowances; lowering prices for customers, including from competitive pricing decisions; improvements in product sourcing and inventory management; and the extent to which our customers accept our free shipping and Amazon Prime offers. Such free shipping and Amazon Prime offers reduce shipping revenue and reduce our gross margins on retail sales. We view our shipping offers as an effective worldwide marketing tool and intend to continue offering them indefinitely.

Sales of products by other sellers on our websites, including sellers on Abebooks which we acquired in December 2008, represented 32% and 30% of unit sales for Q1 2009 and Q1 2008. Since revenues from these sales are recorded as a net amount, they generally result in lower revenues but higher gross margin per unit. Since we focus on profit dollars rather than margins, we are largely neutral on whether an item is sold by us or by another seller.

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

North America segment gross margins in Q1 2009 increased compared to the comparable prior year period due to improvements in inventory management, including vendor pricing, and increases in sales of products by other sellers, partially offset by our efforts to continue reducing prices for our customers and a larger percent of overall sales in lower margin categories such as electronics and other general merchandise.

International segment gross margins in Q1 2009 increased compared to the comparable prior year period due to improvements in inventory management, including vendor pricing, and increases in sales of products by other sellers, partially offset by our efforts to continue reducing prices for our customers, and a larger percent of overall sales in lower margin categories such as electronics and other general merchandise.

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***Supplemental Information***

Supplemental information about shipping results is as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2009 | 2008 |
| | (in millions) | |
| Shipping Activity: | | |
| Shipping revenue (1)(2) | $ 190 | $ 192 |
| Outbound shipping costs | (358) | (320) |
| Net shipping cost | $ (168) | $ (128) |
| Year-over-year Percentage Growth: | | |
| Shipping revenue | (1)% | 27% |
| Outbound shipping costs | 12 | 35 |
| Net shipping cost | 31 | 48 |
| Percent of Net Sales: | | |
| Shipping revenue | 3.9% | 4.7% |
| Outbound shipping costs | (7.3) | (7.8) |
| Net shipping cost | (3.4)% | (3.1)% |

(1) Excludes amounts earned on shipping activities by third-party sellers where we do not provide the fulfillment service.
(2) Includes amounts earned from Amazon Prime membership and Fulfillment by Amazon programs.

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, as well as through membership in Amazon Prime. To the extent our customers accept and use our free shipping offers at an increasing rate, including memberships in Amazon Prime, our net cost of shipping will increase. We seek to partially mitigate the costs of lowering prices over time through achieving higher sales volumes, negotiating better terms with our suppliers, and achieving better operating efficiencies.

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Supplemental information about our net sales is as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2009 | 2008 |
| | (in millions) | |
| Net Sales: | | |
| North America | | |
| Media | $ 1,305 | $ 1,205 |
| Electronics and other general merchandise | 1,172 | 826 |
| Other (1) | 101 | 95 |
| Total North America | $ 2,578 | $ 2,126 |
| International | | |
| Media | $ 1,418 | $ 1,338 |
| Electronics and other general merchandise | 874 | 655 |
| Other (1) | 19 | 16 |
| Total International | $ 2,311 | $ 2,009 |
| Consolidated | | |
| Media | $ 2,723 | $ 2,543 |
| Electronics and other general merchandise | 2,046 | 1,481 |
| Other (1) | 120 | 111 |
| Total consolidated | $ 4,889 | $ 4,135 |
| Year-over-year Percentage Growth: | | |
| North America | | |
| Media | 8% | 22% |
| Electronics and other general merchandise | 42 | 46 |
| Other | 7 | 40 |
| Total North America | 21 | 31 |
| International | | |
| Media | 6% | 34% |
| Electronics and other general merchandise | 34 | 71 |
| Other | 14 | 58 |
| Total International | 15 | 44 |
| Consolidated | | |
| Media | 7% | 28% |
| Electronics and other general merchandise | 38 | 56 |
| Other | 8 | 43 |
| Total consolidated | 18 | 37 |
| Year-over-year Percentage Growth: | | |
| Excluding the effect of exchange rates | | |
| International | | |
| Media | 17% | 22% |
| Electronics and other general merchandise | 50 | 56 |
| Other | 40 | 47 |
| Total International | 28 | 31 |
| Consolidated | | |
| Media | 13% | 21% |
| Electronics and other general merchandise | 46 | 50 |
| Other | 11 | 41 |

| | | |
|---|---|---|
| Total consolidated | 25 | 31 |
| Consolidated Net Sales Mix: | | |
| Media | 56% | 61% |
| Electronics and other general merchandise | 42 | 36 |
| Other | 2 | 3 |
| Total consolidated | 100% | 100% |

(1) Includes non-retail activities, such as other seller sites, miscellaneous marketing and promotional agreements, our co-branded credit card agreements, and Amazon Web Services.

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***Operating Expenses***

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

| | Three Months Ended March 31, 2009 | | | Three Months Ended March 31, 2008 | | |
|---|---|---|---|---|---|---|
| | As Reported | Stock-Based Compensation | Net | As Reported | Stock-Based Compensation | Net |
| Operating Expenses: | | | | | | |
| Fulfillment | $ 422 | $ (15) | $ 407 | $ 354 | $ (11) | $ 343 |
| Marketing | 128 | (4) | 124 | 103 | (2) | 101 |
| Technology and content | 275 | (36) | 239 | 234 | (31) | 203 |
| General and administrative | 68 | (12) | 56 | 61 | (10) | 51 |
| Other operating expense | 11 | | 11 | 6 | | 6 |
| Total operating expenses | $ 904 | $ (67) | $ 837 | $ 758 | $ (54) | $ 704 |
| Year-over-year Percentage Growth: | | | | | | |
| Fulfillment | 19% | | 19% | 36% | | 36% |
| Marketing | 25 | | 24 | 43 | | 42 |
| Technology and content | 18 | | 18 | 26 | | 21 |
| General and administrative | 11 | | 8 | 10 | | 5 |
| Percent of Net Sales: | | | | | | |
| Fulfillment | 8.6% | | 8.3% | 8.6% | | 8.3% |
| Marketing | 2.6 | | 2.5 | 2.5 | | 2.4 |
| Technology and content | 5.6 | | 4.9 | 5.6 | | 4.9 |
| General and administrative | 1.4 | | 1.1 | 1.5 | | 1.2 |

Operating expenses without stock-based compensation are non-GAAP financial measures. See Non-GAAP Financial Measures below and Item 1 of Part I, Financial Statements Note 1 Accounting Policies Stock-Based Compensation.

***Fulfillment***

The increase in fulfillment costs in absolute dollars in Q1 2009 compared to the comparable prior year period relates to variable costs corresponding with sales volume and inventory levels; our mix of product sales; payment processing and related transaction costs, including mix of payment methods and costs from our guarantee for certain seller transactions; and costs from expanding fulfillment capacity.

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

We seek to expand our fulfillment capacity to accommodate greater selection and in-stock inventory levels and meet anticipated shipment volumes from sales of our own products as well as sales by third parties for which we provide the fulfillment services. We periodically evaluate our facility requirements as necessary.

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***Marketing***

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

Marketing costs increased in absolute dollars in Q1 2009 compared to the comparable prior year period due to increased spending in variable online marketing channels, such as our Associates program and sponsored search programs.

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

***Technology and Content***

We seek to efficiently invest in several areas of technology and content including seller platforms, web services, digital initiatives, and expansion of new and existing product categories, as well as technology infrastructure so that we can continue to enhance the customer experience, improve our process efficiency and support our infrastructure web services. We expect spending in technology and content to increase over time as we continue to add employees to our staff and add technology infrastructure.

During Q1 2009 and Q1 2008, we capitalized $41 million (including $6 million of stock-based compensation) and $57 million (including $22 million acquired under business combinations and $6 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $40 million and $33 million for Q1 2009 and Q1 2008.

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

***General and Administrative***

The increase in general and administrative costs in absolute dollars in Q1 2009 compared to the comparable prior year period is primarily due to increases in payroll and related expenses, and professional service fees.

***Stock-Based Compensation***

SFAS No. 123(R) requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The fair value of restricted stock and restricted stock units is determined based on the number of shares granted and the quoted price of our common stock. Such value is recognized as expense over the service period, net of estimated forfeitures, using the accelerated method. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results and future estimates may differ substantially from our current estimates.

Stock-based compensation was $67 million and $54 million during Q1 2009 and Q1 2008. The increase in stock-based compensation is primarily attributable to an increase in total stock compensation value granted to our employees.

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***Other Operating Expense, Net***

Other operating expense, net, was $11 million and $6 million during Q1 2009 and Q1 2008. Other operating expense was primarily attributable to amortization of intangible assets.

***Income from Operations***

Income from operations was $244 million and $198 million during Q1 2009 and Q1 2008. The increase is primarily a result of increased gross profit relative to operating expenses.

***Interest Expense and Income***

The primary component of our net interest expense is the interest we incurred on our long-term debt instruments. Interest expense was $12 million and $22 million during Q1 2009 and Q1 2008 with the decline primarily relating to principal reductions on our long-term debt.

Our interest income was $12 million and $26 million during Q1 2009 and Q1 2008. We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market funds. Our interest income corresponds with the average balance of invested funds and the prevailing rates we are earning on them, which vary depending on the geographies and currencies in which they are invested.

***Other Income, Net***

Other income, net, consisted of the following:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2009 | 2008 |
| | (in millions) | |
| Foreign-currency gain (loss) on remeasurement of 6.875% PEACS | $ 16 | $ (29) |
| Foreign-currency gain (loss) on intercompany balances | (16) | 32 |
| Other | 4 | 2 |
| Total other income, net | $ 4 | $ 5 |

***Income Taxes***

Our tax provision for interim periods is determined using an estimate of our annual effective tax rate. There is a potential for significant volatility of our 2009 effective tax rate due to several factors, including from variability in accurately predicting our taxable income, the taxable jurisdictions to which it relates, and business acquisitions and investments, and foreign currencies. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes we make a cumulative adjustment. The 2009 annual effective tax rate is estimated to be lower than the 35% U.S. federal statutory rate primarily due to anticipated earnings of our subsidiaries outside of the U.S. in jurisdictions where our effective tax rate is lower than in the U.S. Cash paid for income taxes was $11 million and $8 million in Q1 2009 and Q1 2008.

We have current tax benefits and net operating losses relating to excess stock-based compensation deductions that are being utilized to reduce our U.S. taxable income. As such, we expect a majority of our net tax provision to be non-cash.

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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 (in millions, except per share data):

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | | | 2008 | | |
| | At Prior Year Rates (1) | Exchange Rate Effect (2) | As Reported | At Prior Year Rates (1) | Exchange Rate Effect (2) | As Reported |
| Net sales | $ 5,157 | $ (268) | $ 4,889 | $ 3,950 | $ 185 | $ 4,135 |
| Gross profit | 1,213 | (65) | 1,148 | 921 | 35 | 956 |
| Operating expenses | 937 | (33) | 904 | 736 | 22 | 758 |
| Income from operations | 276 | (32) | 244 | 184 | 14 | 198 |
| Net interest income (expense) and other (3) | 1 | 3 | 4 | 6 | 3 | 9 |
| Net income | 198 | (21) | 177 | 132 | 11 | 143 |
| Diluted earnings per share | $ 0.46 | $ (0.05) | $ 0.41 | $ 0.31 | $ 0.03 | $ 0.34 |

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

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

(3) Includes foreign-currency gains and losses on cross-currency investments, remeasurement of 6.875% PEACS and intercompany balances.

***Non-GAAP Financial Measures***

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

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

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

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The following is a reconciliation of free cash flow to the most comparable GAAP measure, Net cash provided by operating activities for the trailing twelve months ended March 31, 2009 and 2008 (in millions):

| | Twelve Months Ended March 31, | |
|---|---|---|
| | 2009 | 2008 |
| Net cash provided by operating activities | $ 1,757 | $ 1,039 |
| Purchases of fixed assets, including internal-use software and website development | (326) | (251) |
| Free cash flow | $ 1,431 | $ 788 |
| Net cash used in investing activities | $ (819) | $ (721) |
| Net cash provided by (used in) financing activities | $ (580) | $ 375 |

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

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

**Guidance**

We provided guidance on April 23, 2009, in our earnings release furnished on Form 8-K as follows:

Second Quarter 2009 Guidance

- Net sales are expected to be between $4.30 billion and $4.75 billion, or to grow between 6% and 17% compared with second quarter 2008.
- Operating income is expected to be between $110 million and $190 million, or decline between 49% and 12% compared with second quarter 2008. The second quarter 2008 results include the $53 million non-cash gain recognized on the sale of the Company s European DVD rental assets.
- This guidance includes approximately $90 million for stock-based compensation and amortization of intangible assets, and it assumes, among other things, that no additional business acquisitions or investments are concluded and that there are no further revisions to stock-based compensation estimates.

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

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

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

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about market risks is set forth below and in Item 2 of Part I, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

***Interest Rate Risk***

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. All of our cash equivalent and marketable fixed income securities are designated as available-for-sale and, accordingly, are presented at fair value on our consolidated balance sheets. We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market 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.

***Foreign Exchange Risk***

During Q1 2009, net sales from our International segment accounted for 47% of our consolidated revenues. Net sales and related expenses generated from our international websites, as well as those relating to *www.amazon.ca* (which is included in our North America segment), are denominated in the functional currencies of the corresponding websites and primarily include British Pounds, Euros and Japanese Yen. The functional currency of our subsidiaries that either operate or support these websites is the same as the corresponding local currency. The results of operations of, and certain of our intercompany balances associated with, our internationally-focused websites are exposed to foreign exchange rate fluctuations. Upon consolidation, as exchange rates vary, net sales and other operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. For example, as a result of fluctuations in foreign exchange rates throughout the period compared to rates in effect the prior year, international segment revenues in Q1 2009 decreased by $258 million in comparison with Q1 2008.

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 March 31, 2009 of $1.2 billion, an assumed 5%, 10%, and 20% negative currency movement would result in fair value declines of $60 million, $120 million, or $245 million. All investments are classified as available for sale, as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Fluctuations in fair value are recorded in Accumulated other comprehensive loss, a separate component of stockholders equity.

We have foreign exchange risk related to our intercompany balances denominated in foreign currency. Based on the intercompany balances at March 31, 2009 of $145 million, an assumed 5%, 10%, and 20% strengthening of the U.S. Dollar in relation to these foreign currencies would result in losses of $5 million, $15 million, and $30 million, recorded to Other income, net.

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

***Investment Risk***

As of March 31, 2009, our recorded basis in equity investments was $89 million. These investments primarily relate to equity-method investments in private companies. We review our investments for impairment when events and circumstances indicate that the decline in fair value of such assets below the carrying value is other-than-temporary. Our analysis includes review of recent operating results and trends, recent sales/acquisitions of the investee securities, and other publicly available data. The current global economic climate provides additional uncertainty. Valuations of private companies are inherently more difficult due to the lack of readily available market data. As such, we believe that market sensitivities are not practicable.

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

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

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

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

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## PART II. OTHER INFORMATION

**Item 1.** ***Legal Proceedings***

See Item 1 of Part I, Financial Statements Note 4 Commitments and Contingencies Legal Proceedings.

**Item 1A.** ***Risk Factors***

Please carefully consider the following risk factors. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected. In addition, the current global economic climate amplifies many of these risks.

***We Face Intense Competition***

Our businesses are rapidly evolving and intensely competitive, and we have many competitors in different industries, including retail, e-commerce services, digital and web services. Many of our current and potential competitors have greater resources, longer histories, more customers, and greater brand recognition. They may secure better terms from vendors, adopt more aggressive pricing and devote more resources to technology, fulfillment, and marketing.

Competition may intensify as our competitors enter into business combinations or alliances and established companies in other market segments expand into our market segments. In addition, new and enhanced technologies, including search, web services, and digital, may increase our competition. The Internet facilitates competitive entry and comparison shopping and renders e-commerce inherently more competitive than other retail. Increased competition may reduce our sales and profits.

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

We are rapidly and significantly expanding our global operations, including increasing our product and service offerings and scaling our infrastructure to support our retail and services businesses. This expansion increases the complexity of our business and places significant strain on our management, personnel, operations, systems, technical performance, financial resources, and internal financial control and reporting functions. We may not be able to manage growth effectively, which could damage our reputation, limit our growth and negatively affect our operating results.

***Our Expansion into New Products, Services, Technologies and Geographic Regions Subjects Us to Additional Business, Legal, Financial and Competitive Risks***

We may have limited or no experience in our newer market segments, and our customers may not adopt our new product or service offerings, which include seller services, digital, web services and electronic devices. These offerings may present new and difficult technology challenges, and we may be subject to claims if customers of these offerings experience service disruptions or failures or other quality issues. In addition, our gross profits in our newer activities may be lower than in our older activities, and we may not be successful enough in these newer activities to recoup our investments in them. If any of this were to occur, it could damage our reputation, limit our growth and negatively affect our operating results.

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

We may not be able to accurately forecast our growth rate. We base our expense levels and investment plans on sales estimates. A significant portion of our expenses and investments is fixed, and we may not be able to adjust our spending quickly enough if our sales are less than expected.

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Our revenue growth may not be sustainable, and our percentage growth rates may decrease. Our revenue and operating profit growth depends on the continued growth of demand for the products and services offered by us or our sellers, and our business is affected by general economic and business conditions worldwide. A softening of demand, whether caused by changes in customer preferences or a weakening of the U.S. or global economies, may result in decreased revenue or growth.

Our net sales and operating results will also fluctuate for many other reasons, including due to risks described elsewhere in this section and the following:

- our ability to retain and increase sales to existing customers, attract new customers, and satisfy our customers demands;
- our ability to retain and expand our network of sellers;
- our ability to acquire merchandise on favorable terms, manage inventory, and fulfill orders;
- the introduction of competitive websites, products, services, price decreases, or improvements;
- changes in usage of the Internet and e-commerce, including in non-U.S. markets;
- timing, effectiveness, and costs of expansion and upgrades of our systems and infrastructure;
- the success of our geographic, service and product line expansions;
- the outcomes of legal proceedings and claims;
- variations in the mix of products and services we sell;
- variations in our level of merchandise and vendor returns;
- the extent to which we offer free shipping, continue to reduce product prices worldwide, and provide additional benefits to our customers;
- the extent to which we invest in technology and content, fulfillment and other expense categories;
- increases in the prices of fuel and gasoline, as well as increases in the prices of other energy products and commodities like paper and packing supplies;

the extent to which operators of the networks between our customers and our websites successfully charge fees to grant our customers unimpaired and unconstrained access to our online services;

our ability to collect amounts owed to us when they become due;

the extent to which use of our services is affected by spyware, viruses, phishing and other spam emails, denial of service attacks, data theft, computer intrusions and similar events; and

terrorist attacks and armed hostilities.

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

Our international activities are significant to our revenues and profits, and we plan to further expand internationally. We have relatively little experience operating in these or future market segments and may not benefit from any first-to-market advantages or otherwise succeed. It is costly to establish, develop and maintain international operations and websites and promote our brand internationally. Our international operations may not be profitable on a sustained basis.

In addition to risks described elsewhere in this section, our international sales and operations are subject to a number of risks, including:

local economic and political conditions;

government regulation of e-commerce or other online services and restrictive governmental actions (such as trade protection measures, including export duties and quotas and custom duties and tariffs), nationalization and restrictions on foreign ownership;

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- restrictions on sales or distribution of certain products or services and uncertainty regarding liability for products, services and content, including uncertainty as a result of less Internet-friendly legal systems, local laws, lack of legal precedent, and varying rules, regulations, and practices regarding the distribution of media products and enforcement of intellectual property rights;

- import, export, or other business licensing requirements;

- limitations on the repatriation and investment of funds and foreign currency exchange restrictions;

- limited fulfillment and technology infrastructure;

- shorter payable and longer receivable cycles and the resultant negative impact on cash flow;

- laws and regulations regarding consumer and data protection, privacy, network security, encryption, and restrictions on pricing or discounts;

- lower levels of use of the Internet;

- lower levels of consumer spending and fewer opportunities for growth compared to the U.S.;

- lower levels of credit card usage and increased payment risk;

- difficulty in staffing, developing and managing foreign operations as a result of distance, language and cultural differences;

- different employee/employer relationships and the existence of workers councils and labor unions;

- laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans and taxes; and

- geopolitical events, including war and terrorism.

As the international e-commerce channel grows, competition will 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 names. We may not be able to hire, train, retain, and manage required personnel, which may limit our international growth.

In 2004, we acquired Joyo.com Limited, which is organized under the laws of the British Virgin Islands and through a People s Republic of China ( PRC ) entity, provides technology and services for the Joyo Amazon websites. The PRC regulates Joyo Amazon s business through regulations and license requirements restricting (i) foreign investment in the Internet, retail and delivery sectors, (ii) Internet content and (iii) the sale of media and other products. In order to meet local ownership and regulatory licensing requirements, Joyo Amazon s business is operated by PRC companies owned by nominee shareholders who are PRC nationals. Although we believe Joyo Amazon s structure complies with existing PRC laws, it involves unique risks. There are substantial uncertainties regarding the interpretation of PRC laws and regulations, and it is possible that the PRC government will ultimately take a view contrary to ours. If Joyo Amazon (including its subsidiary and affiliates) were found to be in violation of any existing or future PRC laws or regulations or if interpretations of those laws and regulations were to change, the business could be subject to fines and other financial penalties, have its licenses revoked or be forced to shut down entirely. In addition, if Joyo Amazon

were unable to enforce its contractual relationships with respect to management and control of its business, it might be unable to continue to operate the business.

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

If we do not adequately predict customer demand or otherwise optimize and operate our fulfillment centers successfully, it could result in excess or insufficient inventory or fulfillment capacity, result in increased costs, impairment charges, or both, or harm our business in other ways. A failure to optimize inventory will increase our net shipping cost by requiring long-zone or partial shipments. Orders from several of our websites are fulfilled primarily from a single location, 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

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centers. As we continue to add fulfillment and warehouse capability or add new businesses with different fulfillment requirements, our fulfillment network becomes increasingly complex and operating it becomes more challenging. 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. There can be no assurance that we will be able to operate our network effectively.

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

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

***The Seasonality of Our Business Places Increased Strain on Our Operations***

We expect a disproportionate amount of our net sales to occur during our fourth quarter. If we do not stock or restock popular products in sufficient amounts 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. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery for the holiday season. If too many customers access our websites within a short period of time due to increased holiday 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 and customer service centers during these peak periods and delivery and other fulfillment companies and customer service co-sourcers may be unable to meet the seasonal demand. We also face risks described elsewhere in this Item 1A relating to fulfillment center optimization and inventory.

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

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

We provide e-commerce services to other businesses, such as through our seller programs, including Webstore by Amazon and Fulfillment by Amazon, as well as through other commercial agreements, strategic alliances and business relationships. Under these agreements, we provide technology, fulfillment and other services, as well as enable sellers to offer products or services through our websites and power their websites. These arrangements are complex and require substantial personnel and resource commitments by us, which may limit the agreements we are able to enter into and our ability to integrate and deliver services under them. If we

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fail to implement, maintain, and develop the components of these commercial relationships, which may include fulfillment, customer service, inventory management, tax collection, payment processing, licensing of third-party software, hardware, and content, and engaging third parties to perform hosting and other services, these initiatives may not be viable. The amount of compensation we receive under certain of these agreements is partially dependent on the volume of the other company s sales. Therefore, if the other company s offering is not successful, the compensation we receive may be lower than expected or the agreement may be terminated. Moreover, we may not be able to enter into additional commercial relationships and strategic alliances on favorable terms. We also may be subject to claims from businesses to which we provide these services if we are unsuccessful in implementing, maintaining or developing these services.

As our agreements terminate, we may be unable to renew or replace these agreements on comparable terms, or at all. Some of our agreements involve high margin services, such as marketing and promotional agreements, and as they expire they may be replaced, if at all, by agreements involving lower margin services. We may in the future enter into amendments on less favorable terms or encounter parties that have difficulty meeting their contractual obligations to us, which could adversely affect our operating results.

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

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

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

We have acquired and invested in a number of companies, and we may acquire or invest in or enter into joint ventures with additional companies. These transactions create risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- problems retaining key personnel;
- additional operating losses and expenses of the businesses we acquired or in which we invested;
- the potential impairment of amounts capitalized as intangible assets and goodwill as part of the acquisition;
- the potential impairment of customer and other relationships of the company we acquired or in which we invested or our own customers as a result of any integration of operations;
- the difficulty of incorporating acquired technology and rights into our offerings and unanticipated expenses related to such integration;

the difficulty of integrating a new company s accounting, financial reporting, management, information, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;

the difficulty of implementing at companies we acquire the controls, procedures and policies appropriate for a larger public company;

potential unknown liabilities associated with a company we acquire or in which we invest; and

for foreign transactions, additional risks related to the integration of operations across different cultures and languages, and the economic, political, and regulatory risks associated with specific countries.

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As a result of future acquisitions or mergers, we might need to issue additional equity securities, spend our cash, or incur debt, contingent liabilities, or amortization expenses related to intangible assets, any of which could reduce our profitability and harm our business. In addition, valuations supporting our acquisitions and strategic investments could change rapidly given the current global economic climate. We could determine that such valuations have experienced impairments or other-than-temporary declines in fair value which could adversely impact our financial results.

***We Have Foreign Exchange Risk***

The results of operations of, and certain of our intercompany balances associated with, our international websites are exposed to foreign exchange rate fluctuations. Upon translation, operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. As we have expanded our international operations, our exposure to exchange rate fluctuations has increased. We also hold cash equivalents and/or marketable securities primarily in Euros, British Pounds, and Japanese Yen. 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.

***The Loss of Key Senior Management Personnel Could Negatively Affect Our Business***

We depend on our senior management and other key personnel, particularly Jeffrey P. Bezos, our President, CEO, and Chairman. We do not have key person life insurance policies. The loss of any of our executive officers or other key employees could harm our business.

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

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

Our computer and communications systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins, and similar events or disruptions. Any of these events could cause system interruption, delays, and loss of critical data, and could prevent us from accepting and fulfilling customer orders and providing services, which would make our product and service offerings less attractive. Our systems are not fully redundant and our disaster recovery planning may not be sufficient. In addition, we may have inadequate insurance coverage to compensate us for any related losses. Any of these events could damage our reputation and be expensive to remedy.

***We Face Significant Inventory Risk***

In addition to risks described elsewhere in this Item 1A relating to fulfillment center and inventory optimization by us and third parties, we are exposed to significant inventory risks that may adversely affect our operating results as a result of seasonality, new product launches, rapid changes in product cycles, changes in consumer demand and consumer spending patterns, changes in consumer tastes with respect to our products and other factors. We endeavor to accurately predict these trends and avoid overstocking or understocking products we manufacture and/or sell. Demand for products, however, can change significantly between the time inventory or components are ordered and the date of sale. In addition, when we begin selling or manufacturing a new product, it may be difficult to establish vendor relationships, determine appropriate product or component selection, and accurately forecast demand. The acquisition of certain types of inventory or components may

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require significant lead-time and prepayment and they may not be returnable. We carry a broad selection and significant inventory levels of certain products, such as consumer electronics, and we may be unable to sell products in sufficient quantities or during the relevant selling seasons. Any one of the inventory risk factors set forth above may adversely affect our operating results.

***We May Not Be Able to Adequately Protect Our Intellectual Property Rights or May Be Accused of Infringing Intellectual Property Rights of Third Parties***

We regard our trademarks, service marks, copyrights, patents, trade dress, trade secrets, proprietary technology, and similar intellectual property as critical to our success, and we rely on trademark, copyright, and patent law, trade secret protection, and confidentiality and/or license agreements with our employees, customers, and others to protect our proprietary rights. Effective intellectual property protection may not be available in every country in which our products and services are made available. 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.

We may not be able to discover or determine the extent of any unauthorized use of our proprietary rights. Third parties that license our proprietary rights also may take actions that diminish the value of our proprietary rights or reputation. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, the steps we take to protect our intellectual property may not adequately protect our rights or prevent third parties from infringing or misappropriating our proprietary rights. We also cannot be certain that others will not independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights.

Other parties also may claim that we infringe their proprietary rights. We have been subject to, and expect to continue to be subject to, claims and legal proceedings regarding alleged infringement by us of the 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 payment of damages. 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. These risks have been amplified by the increase in third parties whose sole or primary business is to assert such claims.

Our digital content offerings depend in part on effective digital rights management technology to control access to digital content. If the digital rights management technology that we use is compromised or otherwise malfunctions, we could be subject to claims, and content providers may be unwilling to include their content in our service.

***We Have a Rapidly Evolving Business Model and Our Stock Price Is Highly Volatile***

We have a rapidly evolving business model. The trading price of our common stock fluctuates significantly in response to, among other risks, the risks described elsewhere in this Item 1A, as well as:

- changes in interest rates;
- conditions or trends in the Internet and the e-commerce industry;
- quarterly variations in operating results;
- fluctuations in the stock market in general and market prices for Internet-related companies in particular;
- changes in financial estimates by us or securities analysts and recommendations by securities analysts;

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changes in our capital structure, including issuance of additional debt or equity to the public;

changes in the valuation methodology of, or performance by, other e-commerce companies; and

transactions in our common stock by major investors and certain analyst reports, news, and speculation.

Volatility in our stock price could adversely affect our business and financing opportunities and force us to increase our cash compensation to employees or grant larger stock awards than we have historically, which could hurt our operating results or reduce the percentage ownership of our existing stockholders, or both.

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

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet and e-commerce. Existing and future laws and regulations may impede the growth of the Internet or online services. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, mobile communications, electronic contracts and other communications, consumer protection, the provision of online payment services, unencumbered Internet access to our services, the design and operation of websites, and the characteristics and quality of products and services. It is not clear how existing laws governing issues such as property ownership, libel, and personal privacy apply to the Internet and e-commerce. Jurisdictions may regulate consumer-to-consumer online businesses, including certain aspects of our seller programs. Unfavorable regulations and laws could diminish the demand for our products and services and increase our cost of doing business.

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

We do not collect sales or other taxes on shipments of most of our goods into most states in the U.S. Under some of our commercial agreements, the other company is the seller of record, and we are obligated to collect sales tax in accordance with that company s instructions. We may enter into additional agreements requiring similar tax collection obligations. Our fulfillment center and customer service center networks, and any future expansion of them, along with other aspects of our evolving business, may result in additional sales and other tax obligations.

Currently, U.S. Supreme Court decisions 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 or adopted initiatives that could limit or supersede the Supreme Court s position regarding sales and use taxes on Internet sales. If these initiatives are successful, we could be required to collect sales and use taxes in additional states. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us, put us at a competitive disadvantage if they do not impose similar obligations on all of our online competitors and decrease our future sales.

We collect consumption tax (including value added tax, goods and services tax, and provincial sales tax) as applicable on goods and services sold by us that are ordered on our international sites. Additional foreign countries may seek to impose sales or other tax collection obligations on us.

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.

***We Could be Subject to Additional Income Tax Liabilities***

We are subject to income taxes in the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our worldwide provision for income taxes. During the ordinary course of business, there are many transactions for which the ultimate tax determination is uncertain. For example, our

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effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in the relevant tax, accounting and other laws, regulations, principles and interpretations. We are subject to audit in various jurisdictions, and such jurisdictions may assess additional income tax against us. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect on our operating results or cash flows in the period or periods for which that determination is made.

***Our Vendor Relationships Subject Us to a Number of Risks***

We have significant vendors that are important to our sourcing, manufacturing and any related ongoing servicing of merchandise and content. We do not have long-term arrangements with most of our vendors to guarantee availability of merchandise, content, components or services, particular payment terms, or the extension of credit limits. If our current vendors were to stop selling merchandise, content, components or services to us on acceptable terms, including as a result of one or more vendor bankruptcies due to poor economic conditions, we may be unable to procure from other vendors in a timely and efficient manner and on acceptable terms, or at all.

***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 or manufacture may expose us to product liability claims relating to personal injury, death, or environmental or property damage, and may require product recalls or other actions. Certain third parties 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 protection 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 agreements with our vendors and sellers do not indemnify us from product liability.

***We Are Subject to Payments-Related Risks***

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

In addition, we qualify as a money services business in certain jurisdictions because we enable customers to keep account balances with us and transfer money to third parties, and because we provide services to third parties to facilitate payments on their behalf. In these jurisdictions, we may be subject to requirements for licensing, regulatory inspection, bonding, the handling of transferred funds and consumer disclosures. We are also subject to or voluntarily comply with a number of other laws and regulations relating to money laundering,

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international money transfers, privacy and information security and electronic fund transfers. If we were found to be in violation of applicable laws or regulations, we could be subject to civil and criminal penalties or forced to cease our payments services business.

***We Could Be Liable for Breaches of Security on Our Websites***

Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent payment transactions and other security breaches, failure to prevent or mitigate such fraud or breaches may adversely affect our operating results.

***We Could Be Liable for Fraudulent or Unlawful Activities of Sellers***

The law relating to the liability of providers of online payment services is currently unsettled. In addition, governmental agencies could require changes in the way this business is conducted. Under our seller programs, we may be unable to prevent sellers from collecting payments, fraudulently or otherwise, when buyers never receive the products they ordered or when the products received are materially different from the sellers descriptions. Under our A2Z Guarantee, we reimburse buyers for payments up to certain limits in these situations, and as our marketplace seller sales grow, the cost of this program will increase and could negatively affect our operating results. We also may be unable to prevent sellers on our sites or through other seller sites from selling unlawful goods, from selling goods in an unlawful manner, or violating the proprietary rights of others, and could face civil or criminal liability for unlawful activities by our sellers.

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

None.

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

None.

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

None.

**Item 5.** ***Other Information***

None.

**Item 6.** ***Exhibits***

See exhibits listed under the Exhibit Index below.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMAZON.COM, INC. (REGISTRANT)

By: /s/ Shelley Reynolds
**Shelley Reynolds**

**Vice President, Worldwide Controller**

**(Principal Accounting Officer)**

Dated: April 23, 2009

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**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 Current Report on Form 8-K, dated February 18, 2009). |
| 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. |