AMAZON COM INC
Form 10-Q
July 23, 2010
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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 June 30, 2010

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.)

410 Terry Avenue North, Seattle, WA 98109-5210

(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 x 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

447,825,009 shares of common stock, par value $0.01 per share, outstanding as of July 15, 2010

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AMAZON.COM, INC.

FORM 10-Q

For the Quarterly Period Ended June 30, 2010

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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 June 30,		Six Months Ended June 30,		Twelve Months Ended June 30,	
	2010	2009	2010	2009	2010	2009
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 1,844	$ 1,701	$ 3,444	$ 2,769	$ 1,936	$ 1,548
OPERATING ACTIVITIES:						
Net income	207	142	505	319	1,088	663
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	129	84	249	171	456	323
Stock-based compensation	111	85	196	152	386	300
Other operating expense (income), net	25	60	51	71	83	86
Losses (gains) on sales of marketable securities, net	0	0	0	(2)	(2)	(1)
Other expense (income), net	(22)	(14)	(27)	(12)	(31)	(53)
Deferred income taxes	(8)	6	(28)	7	49	30
Excess tax benefits from stock-based compensation	(75)	(20)	(161)	(70)	(196)	(122)
Changes in operating assets and liabilities:						
Inventories	(141)	(23)	180	84	(435)	(261)
Accounts receivable, net and other	(42)	16	412	183	(252)	(149)
Accounts payable	(81)	56	(1,972)	(1,073)	959	625
Accrued expenses and other	200	(6)	(161)	(128)	265	182
Additions to unearned revenue	161	207	349	413	990	696
Amortization of previously unearned revenue	(214)	(125)	(441)	(232)	(799)	(441)
Net cash provided by (used in) operating activities	250	468	(848)	(117)	2,561	1,878
INVESTING ACTIVITIES:						
Purchases of fixed assets, including internal-use software and website development	(196)	(78)	(336)	(133)	(575)	(336)
Acquisitions, net of cash acquired, and other	(21)	(19)	(40)	(35)	(45)	(129)
Sales and maturities of marketable securities and other investments	1,208	378	2,080	692	3,354	1,545
Purchases of marketable securities and other investments	(1,466)	(560)	(2,721)	(951)	(5,661)	(1,877)
Net cash provided by (used in) investing activities	(475)	(279)	(1,017)	(427)	(2,927)	(797)
FINANCING ACTIVITIES:						
Excess tax benefits from stock-based compensation	75	20	161	70	196	122
Common stock repurchased						(100)
Proceeds from long-term debt and other	5	2	67	6	133	44
Repayments of long-term debt, capital lease, and finance lease obligations	(37)	(25)	(98)	(368)	(186)	(663)
Net cash provided by (used in) financing activities	43	(3)	130	(292)	143	(597)

Foreign-currency effect on cash and cash equivalents	(33)	49	(80)	3	(84)	(96)
Net increase (decrease) in cash and cash equivalents	(215)	235	(1,815)	(833)	(307)	388
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 1,629	$ 1,936	$ 1,629	$ 1,936	$ 1,629	$ 1,936
SUPPLEMENTAL CASH FLOW INFORMATION:						
Cash paid for interest	$ 3	$ 2	$ 5	$ 28	$ 9	$ 43
Cash paid for income taxes	43	23	46	34	60	64
Fixed assets acquired under capital leases	83	19	142	37	252	118
Fixed assets acquired under build-to-suit leases	60	61	120	117	191	173

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 June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net sales	$ 6,566	$ 4,651	$ 13,697	$ 9,541
Operating expenses (1):				
Cost of sales	4,957	3,518	10,458	7,260
Fulfillment	582	409	1,128	831
Marketing	211	129	412	257
Technology and content	408	299	773	575
General and administrative	113	77	210	145
Other operating expense (income), net	25	60	51	71
Total operating expenses	6,296	4,492	13,032	9,139
Income from operations	270	159	665	402
Interest income	12	8	23	20
Interest expense	(9)	(7)	(16)	(19)
Other income (expense), net	24	19	27	24
Total non-operating income (expense)	27	20	34	25
Income before income taxes	297	179	699	427
Provision for income taxes	(88)	(39)	(189)	(108)
Equity-method investment activity, net of tax	(2)	2	(5)	
Net income	$ 207	$ 142	$ 505	$ 319
Basic earnings per share	$ 0.46	$ 0.33	$ 1.13	$ 0.74
Diluted earnings per share	$ 0.45	$ 0.32	$ 1.11	$ 0.73
Weighted average shares used in computation of earnings per share:				
Basic	447	431	446	430
Diluted	455	440	455	438
(1) Includes stock-based compensation as follows:				
Fulfillment	$ 24	$ 20	$ 42	$ 35
Marketing	7	5	12	9

Technology and content	58	46	103	82
General and administrative	22	14	39	26

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)

	June 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,629	$ 3,444
Marketable securities	3,479	2,922
Inventories	1,940	2,171
Accounts receivable, net and other	805	988
Deferred tax assets	265	272
Total current assets	8,118	9,797
Fixed assets, net	1,704	1,290
Deferred tax assets	29	18
Goodwill	1,229	1,234
Other assets	1,317	1,474
Total assets	$ 12,397	$ 13,813
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,545	$ 5,605
Accrued expenses and other	1,705	1,759
Total current liabilities	5,250	7,364
Long-term debt	132	109
Other long-term liabilities	1,158	1,083
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 464 and 461		
Outstanding shares 448 and 444	5	5
Treasury stock, at cost	(600)	(600)
Additional paid-in capital	6,056	5,736
Accumulated other comprehensive loss	(282)	(56)
Retained earnings	678	172
Total stockholders equity	5,857	5,257
Total liabilities and stockholders equity	$ 12,397	$ 13,813

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 2010 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 in Item 8 of Part II, Financial Statements and Supplementary Data, of our 2009 Annual Report on Form 10-K.

Prior Period Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. We no longer present gross profit in our consolidated statement of operations as we believe income from operations is a more meaningful measure due to the diversity of our product categories and services.

Principles of Consolidation

The consolidated financial statements include the accounts of Amazon.com, Inc., its wholly-owned subsidiaries, and those entities in which we have a variable interest and are the primary beneficiary (collectively, the Company). Intercompany balances and transactions have been eliminated.

Use of Estimates

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

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance on the consolidation of variable interest entities. The new guidance requires a qualitative approach to identifying a controlling financial interest in a variable interest entity (VIE), and requires ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder the primary beneficiary of the VIE. We adopted this guidance on January 1, 2010. Adoption did not have a material impact on our consolidated financial statements.

On January 1, 2010, we prospectively adopted ASU 2009-13, which amends ASC Topic 605, *Revenue Recognition.* Under this standard, we allocate revenue in arrangements with multiple deliverables using estimated selling prices if we do not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables. Estimated selling prices are management s best estimates of the prices that we would charge our customers if we were to sell the standalone elements separately.

Sales of our Kindle e-reader are considered arrangements with multiple deliverables, consisting of the device, wireless access and delivery, and software upgrades. Under the prior accounting standard, we accounted for sales of the Kindle ratably over the average estimated life of the

device. Accordingly, revenue and associated product cost of the device through December 31, 2009, were deferred at the time of sale and recognized on a straight-line basis over the two year average estimated economic life.

As of January 2010, we account for the sale of the Kindle as three deliverables. The revenue related to the device, which is the substantial portion of the total sale price, and related costs are recognized upon delivery. Revenue related to wireless access and delivery and software upgrades is amortized over the average life of the device, which remains estimated at two years.

Because we have adopted ASU 2009-13 prospectively, we are recognizing $508 million throughout 2010 and 2011 for revenue previously deferred under the prior accounting standard.

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

Note 2 Cash, Cash Equivalents, and Marketable Securities

As of June 30, 2010, and December 31, 2009, 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. Our marketable fixed-income securities have maturities of less than 5 years. Cash equivalents and marketable securities are recorded at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. To increase the comparability of fair value measures, the following hierarchy prioritizes the inputs to valuation methodologies used to measure fair value:

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.

We measure the fair value of money market funds and equity securities based on quoted prices in active markets for identical assets or liabilities. All other financial instruments were valued either based on recent trades of securities in inactive markets or based on quoted market prices of similar instruments and other significant inputs derived from or corroborated by observable market data. We did not hold any securities categorized as Level 3 as of June 30, 2010, or December 31, 2009.

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

	June 30, 2010				December 31, 2009
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Estimated Fair Value	Total Estimated Fair Value
Cash	$ 363	$	$	$ 363	$ 391
Level 1 securities:					
Money market funds	552			552	2,750
Equity securities	2		(1)	1	1
Level 2 securities:					
Foreign government and agency securities	1,487	10		1,497	1,999
U.S. government and agency securities	2,758	13	(1)	2,770	1,268
Corporate debt securities	188	4		192	211
Asset-backed securities	31	1		32	46
Other fixed income securities	12			12	6
	$ 5,393	$ 28	$ (2)	5,419	6,672
Less: Long-term marketable securities (1)				(311)	(306)

Total cash, cash equivalents, and marketable securities	5,108	$	6,366

(1) 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 3 Commitments and Contingencies.

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

Note 3 Commitments and Contingencies

Commitments

We have entered into non-cancellable operating and capital leases for fixed assets and office, fulfillment, and data center facilities. Rental expense under operating lease agreements was $53 million and $41 million for Q2 2010 and Q2 2009, and $100 million and $82 million for the six months ended June 30, 2010 and 2009.

In December 2007, we entered into a series of build-to-suit 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 between 2010 and 2013, with options to extend for two five-year periods. Related to these leases, we currently occupy 430,000 square feet of office space and expect to occupy approximately 1.27 million square feet of additional office 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 one of the buildings.

For buildings that are under build-to-suit lease arrangements where we have taken occupancy in Q2 2010, we determined that we continue to be the deemed owner of these buildings. These arrangements do not qualify for sales recognition under the sale-leaseback accounting guidance due principally to our significant investment in tenant improvements. As a result, the buildings in the amount of $140 million have been reclassified within Fixed assets from Construction in progress to Other corporate assets and are being depreciated over the shorter of their useful lives or the lives of the related leases. The long-term construction obligation is now considered a long-term financing obligation with amounts payable during the next 12 months recorded as Accrued expenses and other.

The following summarizes our principal contractual commitments, excluding open orders for inventory purchases that support normal operations, as of June 30, 2010:

	Six Months Ended December 31, 2010	Year Ended, December 31 2011	2012	2013	2014	Thereafter	Total
				(in millions)			
Operating and capital commitments:							
Debt principal and interest	$ 40	$ 51	$ 59	$ 59	$	$	$ 209
Capital leases, including interest	90	144	92	27	7	2	362
Financing obligations, including interest (1)	6	13	13	14	14	155	215
Operating leases	92	180	158	142	131	395	1,098
Other commitments (2) (3)	137	92	78	71	67	981	1,426
Total commitments	$ 365	$ 480	$ 400	$ 313	$ 219	$ 1,533	$ 3,310

(1) Relates to the 430,000 square feet of occupied corporate office space under build-to-suit lease arrangements.

(2) Includes the estimated timing and amounts of payments for rent, operating expenses, and tenant improvements associated with approximately 1.27 million square feet of corporate office space being developed in Seattle, Washington. 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.

(3) Includes tax contingencies under Accounting Standards Codification 740 (ASC 740), but excludes $196 million of tax contingencies for which we cannot make a reasonably reliable estimate of the amount and period of payment.

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

Pledged Securities

We have pledged or otherwise restricted a portion of our cash and marketable securities as collateral for standby and trade 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 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. 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, 2009	$ 142	$ 157	$ 4	$ 303
Net change in collateral pledged	(8)	18	(1)	9
Balance at June 30, 2010	$ 134	$ 175	$ 3	$ 312

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

(2) At June 30, 2010, our market capitalization was $49 billion. The required amount of collateral to be pledged will increase by $1.5 million if our market capitalization is equal to or below $40 billion, an additional $5 million if our market capitalization is equal to or below $18 billion, and 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 matters described in Item 8 of Part II, Financial Statements and Supplementary Data Note 7 Commitments and Contingencies Legal Proceedings of our 2009 Annual Report on Form 10-K, and in Item 1 of Part I, Financial Statements Note 3, Commitments and Contingencies Legal Proceedings of our Quarterly Report on Form 10-Q for the Period Ended March 31, 2010, as supplemented by the following:

In October 2009, Leon Stambler filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleged, among other things, that our use of secure online payments systems and services infringes two patents owned by Stambler purporting to cover a Method for Securing Information Relevant to a Transaction (U.S. Patent Nos. 5,793,302 and 5,974,148) and sought monetary damages, costs and attorneys fees. On June 9, 2010, Stambler voluntarily dismissed all claims against us in this lawsuit with prejudice.

In May 2010, Stragent, LLC and Seesaw Foundation 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 certain of our Amazon Web Services (AWS) technologies infringe a patent licensed by the plaintiffs purporting to cover a Method of Providing Data Dictionary-Driven Web-Based Database Applications (U.S. Patent No. 6,832,226) and seeks monetary damages, a future royalty, costs and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In May 2010, Site Update Solutions 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 Site Update purporting to

cover a Process for Maintaining Ongoing Registration for Pages on a Given Search Engine (U.S. Patent No. RE40,683) and seeks monetary damages, a future royalty, costs and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In May 2010, Sharing Sound 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 licensed by the plaintiffs purporting to cover a Distribution of Musical Products by a Website Vendor Over the Internet (U.S. Patent No. 6,233,682) and seeks monetary damages, injunctive relief, 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 the claims, proceedings and litigation in which the Company is involved could materially affect our business, results of operations, financial position, or cash flows.

See also Note 6 Income Taxes.

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

Note 4 Stockholders Equity

Stock Award Activity

We granted restricted stock units representing 1.5 million and 4.1 million shares of common stock during Q2 2010 and Q2 2009 with a per share weighted average fair value of $137.78 and $74.45. For the six months ended June 30, 2010 and 2009, we granted restricted stock units representing 3.9 million and 4.8 million shares of common stock with a per share weighted average fair value of $135.51 and $72.37.

Common shares outstanding plus shares underlying outstanding stock awards totaled 465 million and 461 million at June 30, 2010, and December 31, 2009. These totals include all stock-based awards outstanding, including those awards we estimate will be forfeited.

The following table summarizes our restricted stock unit activity for the six months ended June 30, 2010 (in millions):

	Number of Units
Outstanding at December 31, 2009	15.7
Units granted	3.9
Units vested	(2.9)
Units cancelled	(0.6)
Outstanding at June 30, 2010	16.1

Scheduled vesting for outstanding restricted stock units at June 30, 2010, is as follows (in millions):

	Six Months Ended December 31, 2010	Year Ended December 31, 2011	2012	2013	2014	Thereafter	Total
Scheduled vesting restricted stock units	2.9	5.4	4.1	2.0	0.9	0.8	16.1

As of June 30, 2010, there was $616 million of net unrecognized compensation cost related to unvested stock-based compensation arrangements. This compensation is recognized on an accelerated basis, with approximately half of the compensation expected to be expensed in the next twelve months, and has a weighted average recognition period of 1.4 years.

Note 5 Comprehensive Income

Comprehensive income was $70 million and $227 million for Q2 2010 and Q2 2009, and $280 million and $384 million for the six months ended June 30, 2010 and 2009. 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 6 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 2010 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 in jurisdictions where our effective tax rate is lower than in the U.S. Cash paid for income taxes was $43 million and $23 million in Q2 2010 and Q2 2009, and $46 million and $34 million for the six months ended June 30, 2010 and 2009.

As of June 30, 2010, and December 31, 2009, tax contingencies (gross unrecognized tax benefits) were $207 million and $181 million.

We are under examination, or may be subject to examination, by the Internal Revenue Service (IRS) for calendar years 2005 through 2009. Additionally, any net operating losses that were generated in prior years and utilized in 2005 through 2009 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 2005 through 2009, France for 2007 through 2009, Germany for 2003 through 2009, Japan for 2006 through 2009, Luxembourg for 2005 through 2009, and the United Kingdom for 2004 through 2009.

In addition, in 2007, Japanese tax authorities assessed income tax, including penalties and interest, of approximately $120 million against one of our U.S. subsidiaries for the years 2003 through 2005. Proceedings on the assessment were stayed during negotiations between U.S. and Japanese tax authorities over the double taxation issues the assessment raised, and we provided bank guarantees to suspend enforcement of the assessment. In June 2010, the U.S. and Japanese tax authorities reached a tentative agreement on the allocation of our income between the U.S. and Japan for 2003 through 2005, but have not reached agreement on the taxes to be assessed on such income (such agreement would not cover subsequent open years). The amount of estimated tax expense, net of related deductions and foreign tax credits, recorded for this assessment was not significant.

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

We expect the total amount of tax contingences for prior period tax positions to increase over the next 12 months in comparable amounts to the increase over the prior 12 months. It is reasonably possible that within the next 12 months we will receive additional assessments by various tax authorities, although we may not record additional tax contingencies for these assessments.

Note 7 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 operating expenses to segment results, excluding the line item Other operating expense (income), net and operating expenses attributable to stock-based compensation. 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 June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in millions)		(in millions)	
North America				
Net sales	$ 3,590	$ 2,451	$ 7,370	$ 5,030
Operating expenses				
Cost of sales	2,570	1,779	5,332	3,664
Direct segment operating expenses (1)	820	547	1,565	1,091
Segment operating income	$ 200	$ 125	$ 473	$ 275
International				
Net sales	$ 2,976	$ 2,200	$ 6,327	$ 4,511
Operating expenses				
Cost of sales	2,387	1,739	5,126	3,596
Direct segment operating expenses (1)	383	282	762	565
Segment operating income	$ 206	$ 179	$ 439	$ 350
Consolidated				
Net sales	$ 6,566	$ 4,651	$ 13,697	$ 9,541
Operating expenses				
Cost of sales	4,957	3,518	10,458	7,260
Direct segment operating expenses (1)	1,203	829	2,327	1,656
Segment operating income	406	304	912	625
Stock-based compensation	(111)	(85)	(196)	(152)

Other operating income (expense), net	(25)	(60)	(51)	(71)
Income from operations	270	159	665	402
Total non-operating income (expense)	27	20	34	25
Provision for income taxes	(88)	(39)	(189)	(108)
Equity-method investment activity, net of tax	(2)	2	(5)	
Net income	$ 207	$ 142	$ 505	$ 319

(1) Represents the fulfillment, marketing, technology and content, and general and administrative operating expenses, excluding stock-based compensation that are allocated to segments.

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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 2009 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 2009 Annual Report on Form 10-K and Item 1 of Part I, Financial Statements Note 1 Accounting Policies, of this Form 10-Q. 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.

Inventories

Inventories, consisting of products available for sale, are primarily 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.

These assumptions about future disposition of inventory are inherently uncertain. As a measure of sensitivity, for every 1% of additional inventory valuation allowance we would have recorded an additional cost of sales of approximately $21 million for Q2 2010.

Goodwill

We evaluate goodwill for impairment annually and when an event occurs or circumstances change that indicates 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 reporting units. If the fair value is determined to be less than the book value, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value. We estimate the fair value of the reporting units using discounted cash flows. Forecasts of future cash flow are based on our best estimate of future net sales and operating expenses, based primarily on expected category expansion, pricing, market segment share and general economic conditions. Certain estimates of discounted cash flows involve businesses and geographies with limited financial history and developing revenue models. Changes in these forecasts could significantly change the amount of impairment recorded, if any.

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During the quarter, management monitored the actual performance relative to the fair value assumptions used during our annual goodwill impairment test. For the periods presented, no triggering events were identified that require an update to our annual impairment test. As a measure of sensitivity, a 10% decrease in the fair value of any of our reporting units as of December 31, 2009, would have had no impact on the carrying value of our goodwill.

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. As a measure of sensitivity, a prolonged 20% decrease from our June 30, 2010, closing stock price would not be an indicator of possible impairment.

Stock-Based Compensation

We measure compensation cost for stock awards at fair value and recognize it as compensation expense over the service period for awards expected to vest. The fair value of 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 for the amount that will be forfeited, 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 employee class, economic environment, and historical experience. We update our estimated forfeiture rate quarterly. A 1% change to our estimated forfeiture rate would have had an approximately $16 million impact on our Q2 2010 operating income. Our estimated forfeiture rates at June 30, 2010, and December 31, 2009, were 31.5% and 33.1%.

We utilize the accelerated method, rather than the straight-line method, for recognizing compensation expense. Under this method, over 50% of the compensation cost is 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. For example, our 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 foreign currency exchange 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.

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.

Recent Accounting Pronouncements

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

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Liquidity and Capital Resources

Cash flow information is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,		Twelve Months Ended June 30,	
	2010	2009	2010	2009	2010	2009
	(in millions)		(in millions)		(in millions)	
Operating activities	$ 250	$ 468	$ (848)	$ (117)	$ 2,561	$ 1,878
Investing activities	(475)	(279)	(1,017)	(427)	(2,927)	(797)
Financing activities	43	(3)	130	(292)	143	(597)

Our financial focus is on long-term, sustainable growth in free cash flow [1]. Free cash flow, a non-GAAP financial measure, was $1.99 billion for the trailing twelve months ended June 30, 2010, compared to $1.54 billion for the trailing twelve months ended June 30, 2009, an increase of 29%. 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 June 30, 2010, compared to the comparable prior year period was due to increased operating income and changes in working capital, partially offset by increased capital expenditures. 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, 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 $5.1 billion and $6.4 billion at June 30, 2010, and December 31, 2009. Amounts held in foreign currencies were $2.1 billion and $2.8 billion at June 30, 2010, and December 31, 2009, and were primarily Euros, British Pounds, and Japanese Yen.

Cash provided by (used in) operating activities was $250 million and $468 million for Q2 2010 and Q2 2009 and $(848) million and $(117) million for the six months ended June 30, 2010 and 2009. Our operating cash flows result primarily from cash received from our consumer, seller, and developer customers, miscellaneous marketing and promotional agreements, and our co-branded credit card agreements, offset by cash payments we make for products and services, employee compensation (less amounts capitalized related to internal use software that are reflected as cash used in investing activities), payment processing and related transaction costs, and operating leases. 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. Changes to our operating cash flows have historically been driven primarily by changes in operating income and changes to the components of working capital, including changes to receivable and payable days and inventory turns, as well as changes to non-cash items such as excess stock-based compensation and deferred taxes.

Cash provided by (used in) investing activities corresponds with purchases, sales, and maturities of marketable securities and other investments, capital expenditures, including leasehold improvements, internal-use software and website development costs, and cash outlays for acquisitions, equity-method investments, and intellectual property rights. Cash provided by (used in) investing activities was $(475) million and $(279) million for Q2 2010 and Q2 2009 and $(1.0) billion and $(427) million for the six months ended June 30, 2010 and 2009, with the variability caused primarily by purchases, maturities, and sales of marketable securities and other investments and increased capital expenditures. Capital expenditures were $196 million and $78 million during Q2 2010 and Q2 2009 and $336 million and $133 million for the six months ended June 30, 2010 and 2009. The increase in capital expenditures reflects additional investments in support of continued business growth, including capacity to support our fulfillment operations, additional investments in technology infrastructure including AWS, and investments in corporate office space. We expect this trend to continue throughout 2010. Capital expenditures included $44 million and $37 million for internal-use software and website development during Q2 2010 and Q2 2009, and $84 million and $71 million for the six months ended June 30, 2010 and 2009. Stock-based compensation capitalized for internal-use software and website development costs does not affect cash flows. We made cash payments, net of acquired cash, related to acquisition and investment activity of $21 million and $19 million during Q2 2010 and Q2 2009 and $40 million and $35 million during the six months ended June 30, 2010 and 2009.

(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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Cash provided by (used in) financing activities was $43 million and $(3) million for Q2 2010 and Q2 2009 and $130 million and $(292) million for the six months ended June 30, 2010 and 2009. Cash inflows from financing activities primarily result from proceeds from tax benefits relating to excess stock-based compensation deductions and proceeds from long-term debt. Tax benefits relating to excess stock-based compensation deductions are presented as financing cash flows. Cash inflows from tax benefits related to stock-based compensation deductions were $75 million and $20 million for Q2 2010 and Q2 2009, and $161 million and $70 million for the six months ended June 30, 2010 and 2009. Cash outflows from financing activities result from payments on obligations related to capital leases and leases accounted for as financing arrangements and repayments of long-term debt, which were $37 million and $25 million in Q2 2010 and Q2 2009, and $98 million and $368 million for the six months ended June 30, 2010 and 2009.

We recorded net tax provisions of $88 million and $39 million in Q2 2010 and Q2 2009, and $189 million and $108 million for the six months ended June 30, 2010 and 2009. A majority of this provision is non-cash. We have current tax benefits and net operating loss carryforwards relating to excess stock-based compensation deductions that are being utilized to reduce our U.S. taxable income. As such, cash taxes paid were $43 million and $23 million for Q2 2010 and Q2 2009, and $46 million and $34 million for the six months ended June 30, 2010 and 2009. As our federal and state net operating losses and tax credits are utilized, cash paid for taxes will increase. We expect to utilize substantially all of our federal net operating loss carryforwards and tax credits in 2010. We endeavor to optimize our global taxes on a cash basis, rather than on a financial reporting basis.

In January 2010, our Board of Directors authorized a program to repurchase up to $2 billion of our common stock. We did not repurchase common stock in Q2 2010.

See Item 1 of Part I, Financial Statements Note 3 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 $967 million at June 30, 2010. Additionally, in June 2010, we signed an agreement to acquire the equity in Woot, Inc. that we do not currently own. We expect the acquisition to close in Q3 2010, subject to regulatory approvals and closing conditions.

On average, our high inventory turnover means we collect from our customers before our payments to suppliers come due. Inventory turnover[2] was 12 for both Q2 2010 and Q2 2009. 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.

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

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Results of Operations

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

Net Sales

Net sales information is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in millions)		(in millions)	
Net Sales:				
North America	$ 3,590	$ 2,451	$ 7,370	$ 5,030
International	2,976	2,200	6,327	4,511
Consolidated	$ 6,566	$ 4,651	$ 13,697	$ 9,541
Year-over-year Percentage Growth:				
North America	46%	13%	47%	17%
International	35	16	40	16
Consolidated	41	14	44	16
Year-over-year Percentage Growth, excluding effect of exchange rates:				
North America	46%	13%	46%	18%
International	38	28	38	28
Consolidated	42	20	42	22
Net Sales Mix:				
North America	55%	53%	54%	53%
International	45	47	46	47
Consolidated	100%	100%	100%	100%

Sales increased 41% in Q2 2010. Changes in currency exchange rates affected net sales negatively by $48 million for Q2 2010, and positively by $137 million for the six months ended June 30, 2010. For a discussion of the effect on sales growth of exchange rates, see Effect of Exchange Rates below.

The North America sales growth rate was 46% for Q2 2010 and 47% for the six months ended June 30, 2010. This sales growth primarily reflects increased unit sales, a larger base of sales in faster growing categories such as electronics and other general merchandise, and our adoption of the new accounting standard ASU 2009-13 on January 1, 2010, (see Item 1 of Part I, Financial Statements Note 1 Accounting Policies Recent Accounting Pronouncements). Increased unit sales were driven largely by our continued efforts to reduce prices for our customers, including from our free shipping offers and Amazon Prime, by increased in-stock inventory availability and increased selection of product offerings, and by the impact of Zappos, which we acquired in Q4 2009.

The International sales growth rate was 35% for Q2 2010 and 40% for the six months ended June 30, 2010. This sales growth primarily reflects increased unit sales and a larger base of sales in faster growing categories such as electronics and other general merchandise. Increased unit sales were 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. Additionally, changes in currency exchange rates affected International net sales negatively by $54 million for Q2 2010 and positively by $122 million for the six months ended June 30, 2010. We expect that, over time, our International segment will represent 50% or more of our consolidated net sales.

Sales of products by other sellers on our websites represented 32% and 30% of unit sales for Q2 2010 and Q2 2009, and 31% and 30% for the six months ended June 30, 2010 and 2009. Revenues from these sales are recorded as a net amount. We are largely neutral on whether an item is sold by us or by another seller.

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As we continue to offer increased selection, lower prices, and additional product lines within our electronics and other general merchandise category, we expect this category to represent a larger portion of our total sales. See Supplemental Information below.

Supplemental Information

Supplemental information about shipping results is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in millions)		(in millions)	
Shipping Activity:				
Shipping revenue (1)(2)	$ 239	$ 185	$ 486	$ 375
Outbound shipping costs	(487)	(332)	(1,005)	(689)
Net shipping cost	$ (248)	$ (147)	$ (519)	$ (314)
Year-over-year Percentage Growth:				
Shipping revenue	29%	%	29%	(1) %
Outbound shipping costs	47	6	46	9
Net shipping cost	69	14	65	22
Percent of Net Sales:				
Shipping revenue	3.6%	4.0%	3.5%	3.9%
Outbound shipping costs	(7.4)	(7.1)	(7.3)	(7.2)
Net shipping cost	(3.8)%	(3.1)%	(3.8) %	(3.3)%

(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 membership 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 June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(in millions)		(in millions)	
Net Sales:				
North America				
Media	$ 1,324	$ 1,148	$ 2,921	$ 2,454
Electronics and other general merchandise	2,090	1,187	4,114	2,359
Other (1)	176	116	335	217
Total North America	$ 3,590	$ 2,451	$ 7,370	$ 5,030
International				
Media	$ 1,550	$ 1,294	$ 3,383	$ 2,712
Electronics and other general merchandise	1,399	882	2,887	1,756
Other (1)	27	24	57	43
Total International	$ 2,976	$ 2,200	$ 6,327	$ 4,511
Consolidated				
Media	$ 2,874	$ 2,442	$ 6,304	$ 5,166
Electronics and other general merchandise	3,489	2,069	7,001	4,115
Other (1)	203	140	392	260
Total consolidated	$ 6,566	$ 4,651	$ 13,697	$ 9,541
Year-over-year Percentage Growth:				
North America				
Media	15%	%	19%	4%
Electronics and other general merchandise	76	29	74	35
Other	52	16	54	12
Total North America	46	13	47	17
International				
Media	20%	3%	25%	4%
Electronics and other general merchandise	59	45	64	39
Other	13	(8)	32	1
Total International	35	16	40	16
Consolidated				
Media	18%	1%	22%	4%
Electronics and other general merchandise	69	35	70	37
Other	45	11	51	10
Total consolidated	41	14	44	16
Year-over-year Percentage Growth:				
Excluding the effect of exchange rates				
International				
Media	21%	12%	22%	15%
Electronics and other general merchandise	63	60	62	55
Other	18	10	31	22
Total International	38	28	38	28
Consolidated				
Media	18%	7%	20%	10%
Electronics and other general merchandise	70	41	69	44
Other	46	15	50	13

Total consolidated	42	20	42	22
Consolidated Net Sales Mix:				
Media	44%	52%	46%	54%
Electronics and other general merchandise	53	45	51	43
Other	3	3	3	3
Total consolidated	100%	100%	100%	100%

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

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Operating Expenses

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

	Three Months Ended June 30,						Six Months Ended June 30,					
	2010			2009			2010			2009		
	As Reported	Stock-Based Compensation	Net	As Reported	Stock-Based Compensation	Net	As Reported	Stock-Based Compensation	Net	As Reported	Stock-Based Compensation	Net
Operating Expenses:												
Cost of sales	$ 4,957	$	$ 4,957	$ 3,518	0	$ 3,518	$ 10,458	$	$ 10,458	$ 7,260	$	$ 7,260
Fulfillment	582	(24)	558	409	(20)	389	1,128	(42)	1,086	831	(35)	796
Marketing	211	(7)	204	129	(5)	124	412	(12)	400	257	(9)	248
Technology and content	408	(58)	350	299	(46)	253	773	(103)	670	575	(82)	493
General and administrative	113	(22)	91	77	(14)	63	210	(39)	171	145	(26)	119
Other operating expense (income), net	25		25	60		60	51		51	71		71
Total operating expenses	$ 6,296	$ (111)	$ 6,185	$ 4,492	$ (85)	$ 4,407	$ 13,032	$ (196)	$ 12,836	$ 9,139	$ (152)	$ 8,987
Year-over-year Percentage Growth:												
Fulfillment	42%		43%	13%		13%	36%		36%	16	%	16%
Marketing	64		65	26		25	60		61	25		25
Technology and content	36		38	16		16	35		36	17		17
General and administrative	48		45	4		4	46		45	7		6
Percent of Net Sales:												
Fulfillment	8.9%		8.5%	8.8%		8.4%	8.2%		7.9%	8.7	%	8.3%
Marketing	3.2		3.1	2.8		2.7	3.0		2.9	2.7		2.6
Technology and content	6.2		5.3	6.4		5.5	5.6		4.9	6.0		5.2
General and administrative	1.7		1.4	1.6		1.3	1.5		1.3	1.5		1.2

Operating expenses without stock-based compensation are non-GAAP financial measures. See Non-GAAP Financial Measures below.

Cost of Sales

Cost of sales consists of the purchase price of consumer products and content where we are the seller of record, inbound and outbound shipping charges, and packaging supplies. Shipping charges to receive products from our suppliers are included in our inventory, and recognized as cost of sales upon sale of products to our customers. Beginning in Q2 2010 we no longer allocate fulfillment costs related to third party inventory to cost of sales. Such amounts included in cost of sales in prior periods have not been reclassified as the amounts are not material.

Cost of sales increased in absolute dollars in Q2 2010 and for the six months ended June 30, 2010, compared to the comparable prior year periods due to increased product and shipping costs resulting from increased sales and to our adoption of ASU 2009-13 (see Item 1 of Part I, Financial Statements Note 1 Accounting Policies Recent Accounting Pronouncements), offset by improvements in inventory management, including vendor pricing.

Consolidated gross profit and gross margin for each of the periods presented was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009

Gross Profit (in millions)	$ 1,609	$ 1,133	$ 3,239	$ 2,281
Gross Margin	24.5%	24.4%	23.6%	23.9%

Gross margin for Q2 2010 remained relatively consistent with the comparable prior year period. Using our prior method of allocating third party fulfillment costs to cost of sales, gross margin for Q2 2010 was 24.1%. Gross margin for the six months ended June 30, 2010 decreased compared to the comparable prior year period, due primarily to lower prices for our customers, including free shipping offers and Amazon Prime, offset by changes in product category and service mix, including the impact of Zappos, which we acquired in Q4 2009. We believe that income from operations is a more meaningful measure than gross profit and gross margin due to the diversity of our product categories and services.

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Fulfillment

The increase in fulfillment costs in absolute dollars in Q2 2010 and for the six months ended June 30, 2010, compared to the comparable prior year periods relates to variable costs corresponding with sales volume, inventory levels, and product sales mix; 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. As noted above, beginning in Q2 2010 we no longer allocate fulfillment costs related to third party inventory to cost of sales.

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 seller revenue versus our retail sales, 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.

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.

Marketing costs increased in absolute dollars in Q2 2010 and for the six months ended June 30, 2010, compared to the comparable prior year periods due to increased spending on variable online marketing channels, such as sponsored search programs and the Amazon Associates program, and on television advertising.

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, AWS, 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 AWS. We expect spending in technology and content to increase over time as we continue to add employees and technology infrastructure.

During Q2 2010 and Q2 2009, we capitalized $54 million (including $10 million of stock-based compensation) and $46 million (including $9 million of stock-based compensation) of costs associated with internal-use software and website development. For the six months ended June 30, 2010 and 2009, we capitalized $101 million (including $18 million of stock-based compensation) and $86 million (including $15 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $45 million and $42 million for Q2 2010 and Q2 2009 and $89 million and $82 million for the six months ended June 30, 2010 and 2009.

A significant majority of our technology costs are incurred in the U.S., most of which are allocated to our North America segment. Infrastructure and other technology costs used to support AWS are included in technology and content.

General and Administrative

The increase in general and administrative costs in absolute dollars in Q2 2010 and for the six months ended June 30, 2010, compared to the comparable prior year periods is primarily due to increases in payroll and related expenses and professional service fees.

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Stock-Based Compensation

Compensation cost for all stock-based awards is measured at fair value on date of grant and recognized using an accelerated method over the service period for awards expected to vest. The fair value of 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 are recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures including employee class, the economic environment, and historical experience. Actual results and future estimates may differ substantially from our current estimates.

Stock-based compensation was $111 million and $85 million during Q2 2010 and Q2 2009, and $196 million and $152 million for the six months ended June 30, 2010 and 2009. The increase in stock-based compensation is primarily attributable to an increase in total stock compensation value granted to our employees and a decrease in our estimated forfeiture rate.

Other Operating Expense (Income), Net

Other operating expense (income), net, was $25 million and $60 million during Q2 2010 and Q2 2009, and $51 million and $71 million for the six months ended June 30, 2010 and 2009. The decrease in other operating expense relates primarily to the $51 million legal settlement, substantially all of which was expensed in Q2 2009, partially offset by increased amortization of intangible assets in Q2 2010.

Income from Operations

For the reasons discussed above, income from operations increased 71% to $270 million in Q2 2010, from $159 million in Q2 2009 and 65% to $665 million for the six months ended June 30, 2010, from $402 million for the six months ended June 30, 2009.

Interest Expense and Income

The primary component of our net interest expense is related to our capital leases and leases accounted for as financing arrangements. Interest expense was $9 million and $7 million during Q2 2010 and Q2 2009, and $16 million and $19 million for the six months ended June 30, 2010 and 2009.

Our interest income was $12 million and $8 million during Q2 2010 and Q2 2009, and $23 million and $20 million for the six months ended June 30, 2010 and 2009. 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.

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. There is a potential for significant volatility of our 2010 effective tax rate due to several factors, including from variability in accurately predicting our taxable income, the taxable jurisdictions to which it relates, business acquisitions and investments, and foreign currencies.

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 2010 net tax provision to be non-cash. In Q2 2010, we recorded estimated tax expense associated with the tentative agreement between the Japanese and U.S. tax authorities on the allocation of our income between the U.S. and Japan for 2003 through 2005, resulting in a 3 percentage point increase in our effective tax rate for the quarter. See Item 1 of Part I, Financial Statements Note 6 Income Taxes.

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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 June 30,						Six Months Ended June 30,					
	2010			2009			2010			2009		
	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported
Net sales	$ 6,614	$ (48)	$ 6,566	$ 4,878	$ (227)	$ 4,651	$ 13,560	$ 137	$ 13,697	$ 10,037	$ (496)	$ 9,541
Operating expenses	4,995	(38)	4,957	4,295	197	4,492	10,326	132	10,458	8,705	434	9,139
Income from operations	280	(10)	270	189	(30)	159	660	5	665	464	(62)	402
Net interest income (expense) and other (3)	26	1	27	18	2	20	37	(3)	34	20	5	25
Net income	197	10	207	152	(10)	142	482	23	505	350	(31)	319
Diluted earnings per share	$ 0.43	$ 0.02	$ 0.45	$ 0.34	$ (0.02)	$ 0.32	$ 1.06	$ 0.05	$ 1.11	$ 0.80	$ (0.07)	$ 0.73

(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 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 intercompany balances.

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

The effect on our consolidated statements of operations from changes in exchange rates versus the U.S. Dollar is a non-GAAP financial measure. See Non-GAAP Financial Measures below.

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 measures of Free cash flow, operating expenses with and without stock-based compensation, and the effect of exchange rates on our consolidated statement of operations, meet the definition of non-GAAP financial measures.

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, which we reconcile to Net cash provided by (used in) operating activities, is cash flow from operations reduced by Purchases of fixed assets, including internal-use software and website development. We use free cash flow, and ratios based on it, to conduct and evaluate our business because, although it is similar to cash flow from operations, we believe it typically will present a more conservative measure of cash flows since purchases of fixed assets are a necessary component of ongoing operations.

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 the portion of payments representing principal reductions of obligations related to capital leases and leases accounted for as financing arrangements 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 (used in) operating activities for the trailing twelve months ended June 30, 2010 and 2009 (in millions):

	Twelve Months Ended June 30,	
	2010	2009
Net cash provided by (used in) operating activities	$ 2,561	$ 1,878
Purchases of fixed assets, including internal-use software and website development	(575)	(336)
Free cash flow	$ 1,986	$ 1,542
Net cash used in investing activities	$ (2,927)	$ (797)
Net cash provided by (used in) financing activities	$ 143	$ (597)

Operating expenses with and without stock-based compensation is provided 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 has limitations since it does 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.

Information regarding the effect of exchange rates, versus the U.S. Dollar, on our consolidated statements of operations is provided to show reported period operating results had the exchange rates remained the same as those in effect in the comparable prior year period.

Guidance

We provided guidance on July 22, 2010, in our earnings release furnished on Form 8-K as follows:

Third Quarter 2010 Guidance

- Net sales are expected to be between $6.900 billion and $7.625 billion, or to grow between 27% and 40% compared with third quarter 2009.
- Operating income is expected to be between $210 million and $310 million, or between 16% decline and 24% growth compared with third quarter 2009.
- This guidance includes approximately $130 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 disclosures about market risk 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 Q2 2010, net sales from our International segment accounted for 45% 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 Q2 2010 decreased by $54 million in comparison with Q2 2009.

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 June 30, 2010 of $2.1 billion, an assumed 5%, 10%, and 20% negative currency movement would result in fair value declines of $105 million, $210 million, and $420 million. All investments are classified as available-for-sale. Fluctuations in fair value are recorded in Accumulated other comprehensive loss, a separate component of stockholders equity.

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We have foreign exchange risk related to our intercompany balances denominated in foreign currency. Based on the intercompany balances at June 30, 2010 of $396 million, an assumed 5%, 10%, and 20% strengthening of the U.S. Dollar in relation to these foreign currencies would result in losses of $20 million, $40 million, and $80 million, recorded to Other income (expense), 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.

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Investment Risk

As of June 30, 2010, our recorded basis in equity investments was $104 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.

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 3 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 content and digital media devices, 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 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 offerings. 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, profitability, if any, 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.

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 offer products 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;

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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. In certain international market segments, we have relatively little operating experience 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, other online services and electronic devices 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;

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 physical and digital distribution of media products and enforcement of intellectual property rights;

- business licensing or certification requirements, such as for imports, exports and electronic devices;
- 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

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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 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 profitability. 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 through our seller programs and 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 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

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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. 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 tangible assets, such as inventory, and intangible assets and goodwill acquired in the acquisitions;
- 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.

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.

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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 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

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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;
- 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 or technology 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, E-commerce and Other Aspects of Our Business 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, e-commerce, and electronic devices. Existing and future laws and regulations may impede our growth. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, mobile communications, electronic device certification, electronic waste, 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 or change our business practices. 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.

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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 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 foreign currency exchange 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 alternatives 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 profitability. 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. 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, 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.

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We Could Be Liable for Breaches of Security

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. Reserved

Not applicable.

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: July 22, 2010

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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 June 30, 2000).
3.2	Restated Bylaws of the Company (incorporated by reference to the Company s Current Report on Form 8-K, filed 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.
101	The following financial statements from the Company s Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, formatted in XBRL: (i) Consolidated Statements of Cash Flows, (ii) Consolidated Statements of Operations, (iii) Consolidated Balance Sheets, and (iv) Notes to Consolidated Financial Statements.