Amazon.com Inc.

Company Update

Rating: SELL (*High Risk*)

- ☐ Anemic growth in AMZN's B/M/V segment has caused us to re-examine its valuation.
- ☐ We believe a rational valuation approach reveals significant downside risk to equity holders. We are downgrading to Sell and reducing our price target to $9.

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AMZN ($14.44)—OTC February 15, 2001

	Earnings Per Share Fiscal Year Ending							
	12/00	12/01E	12/02E	P/E 12/01E	Ind. Div.	Yield	Shares O/S (Mil.)	52-Week Range
New	**$(1.19)**	**$(0.94)**	**$(0.55)**	**NM**	**—**	**—**	**356.2**	**76-13**
Old								

DJIA: 10,795.41
S&P 500: 1315.92
PSI Internet Composite Index: 870.99

Priced as of the close, February 14, 2001.

Note: A PSI index's market-cap-weighted performance is on a total-return basis and, in most instances, from 1979. Most Prudential Securities Incorporated indexes (for about 200 industries in 12 economic sectors) are also segmented by small-, mid-, and large-cap stocks. For more information regarding these indexes and their composition please contact your Prudential Securities representative. Prudential Securities research is also available on Bloomberg, First Call/Research Direct, and Multex.

MID CAP Research

What's Amazon Worth? Maybe Less Than Meets The Eye—Downgrading AMZN To Sell From Hold

Amazon.com Inc., based in Seattle, Washington, is the leading Internet retailer, serving more than 29 million customers.

As the year 2000 unfolded, revenue growth at Amazon.com slowed considerably. A combination of a slowing U.S. economy, the law of large numbers, the dot-com meltdown and surrounding publicity, and (in our opinion) household saturation finally caught up with the company and its record of hyper-growth. Total company growth in the fourth quarter of 2000 was not terrible in a slow economy, at 44% above the year-ago quarter. However, growth in AMZN's core U.S. book/music/video (B/M/V) segment was extremely disappointing, up just 11% from fourth-quarter 1999.

A Re-Examination Of AMZN's Valuation... The anemic growth in AMZN's most mature (and only profitable) segment caused us to re-examine AMZN's market valuation. Based on this re-evaluation, we believe that AMZN's market capitalization is overextended, and poses further downside risk to investors, even though the stock is off 87% from its all-time high of $113 (and some would argue that the bad news is already reflected in its current price).

...Spurred Our Downgrade To Sell. Since we now believe that an investment in AMZN holds greater downside risk than upside potential, we are lowering our rating on AMZN to Sell from Hold and our price target to $9 from $20.

We utilized several techniques to help us evaluate a reasonable firm value for AMZN, including a sum-of-the-parts analysis and a discounted cash flow analysis. Based on these analyses, detailed later in this report, we believe a reasonable value for AMZN shares is south of $10 per share, perhaps as low as $8.

Obviously, this value greatly depends upon the inputs into the model. Therefore, to estimate present value, we use what we consider to be a middle-of-the-road scenario, which implies growth rates and operating margins that are similar to those of successful traditional retailers.

What Exactly Is An Investment In AMZN Worth? In our view, the exact value of Amazon.com is impossible to determine at this juncture with currently available information. For if present value is simply the company's future earnings, discounted for the time value of money, then the only certainty about Amazon's future profits is that they are extremely uncertain. However, the recent fourth-quarter results gave investors the first glimpse of what this enigmatic company might look like as it matures.

What we found in the fourth-quarter results was a company with a large, slow-growing, rather profitable U.S. B/M/V business. In addition, Amazon has a fast-growing international segment (which also primarily sells books, music, and video) and a much faster-growing (but money-losing) "early-stage businesses" segment, whose revenue is primarily driven by consumer electronics sales.

For valuation purposes, we prefer to segment these businesses in a slightly different manner than management does, in order to better understand the implicit value the market might be placing on AMZN's business segments. In Figures 1 and 2, we detail our segmentation of AMZN's businesses and illustrate what we consider to be Amazon's global mass-market category-killer profile in books, music, and video. In addition, the company has a consumer electronics store, a toy partnership with Toys "R" Us (TOY—$26.00, rated Accumulate by Prudential Securities's Senior Retailing/Hardlines Analyst Amy E. Ryan), and several other categories (e.g., tools, kitchen, lawn and garden, and auctions) that don't currently contribute much to revenue or firm value. Although some continue to argue that AMZN is a general merchandise retailer, we don't think that this is an accurate title, at least not at present. Amazon.com has yet to demonstrate that its customers wish to buy a wide variety of products online.

Since we believe that Amazon is a category killer in several categories, as opposed to a general merchandise retailer, we can better define the company's future earnings. If we combine Amazon's U.S. B/M/V and international segments, we find a global retailer with more than $2 billion of revenue in full-year 2000. We are very impressed by this, considering that the company sold its first book more than five years ago (in July 1995). Yet, given the fact that the world's largest book retailer, Barnes & Noble, Inc. (BKS—$25.87, rated Accumulate by Amy E. Ryan), is expected to generate revenue of approximately $4 billion in fiscal 2001 (ended January 31, 2001), we are not really surprised that AMZN's fourth-quarter U.S. B/M/V growth was a disappointing 11% above that of fourth-quarter 1999.

Even if we put aside our concerns regarding future growth, and assume that AMZN will be able to grow its global B/M/V revenue at 14%, compounded annually for the next five years, the company would achieve segment revenue of approximately $4 billion in full-year 2006. At that point, we assume that growth would likely settle in at the rate of industry growth, or, in other words, Amazon would then grow at about the same rate as its competition.

We have been impressed with Amazon's ability to effectively raise prices in its U.S. B/M/V segment, but we believe that it has come at the cost of revenue growth. Therefore, for our sum-of-the-parts analysis, we give the company the benefit of the doubt, and assume it will be able to maintain segment operating margins in the range of 7%-8%. In addition, we assume that advertisers will be willing to pay up to reach Amazon's millions of customers, contributing another 2%-3% to the company's operating margin and allowing the company to achieve 10% operating margins in these segments. For comparison, we note that Barnes & Noble, as well as Borders Group (BGP—$15.20, rated Hold by Amy E. Ryan), have historical five-year average operating margins of approximately 5.5%; therefore we implicitly credit AMZN for a more attractive business model than its brick-and-mortar competitors. With these assumptions in place, and a 40% expected tax rate, we project that Amazon's global B/M/V segment will earn approximately $247 million in full-year 2006.

Next, we capitalize the $247 million at a multiple of 25 times future earnings, which translates into a future firm value somewhere in the neighborhood of $6 billion. Of course, an expectation of $6 billion in 2006 is not the same as $6 billion in hand today, so we discount that future firm value at a rate of 15%, compounded annually. Investors who follow our work know that we generally use a 20% discount rate for stocks in our Internet universe, which we deem appropriate for higher-risk companies. However, in this case we isolate Amazon's core B/M/V business, so we believe there is less inherent risk. We calculate that the present segment value is approximately $3 billion.

If we are correct in our assessment of Amazon's $3 billion global B/M/V segment worth, then it would appear that its current $4.8 billion market capitalization is not so far-fetched. However, we must remember that AMZN has $2.1 billion of convertible debt on its balance sheet. After we add the debt and subtract its $1.1 billion in cash (as of December 29, 2000), we are left with a firm value of roughly $6 billion—and the global B/M/V segment only accounts for slightly more than 50% of this firm value. In our view, the difference between our estimated B/M/V segment value and the current firm value is roughly $2.8 billion, or $7.76 per share. We believe this $2.7 billion is the value the market has implicitly placed on Amazon's other category segments.

What's Left? Consumer Electronics And A Few Other Product Categories. If the global B/M/V segment is subtracted from Amazon's business, what are investors left holding? In our view, they are left with a sizable consumer electronics store, a partnership with Toysrus.com, and a few other product category offerings that have yet to interest Amazon's millions of customers. Other than consumer electronics and the company's toy category deal with Toysrus.com, we find it hard to believe that the other businesses could make a significant dent in that additional $2.7 billion in market value. In our analysis we generously value these categories at $100 million. Could the consumer electronics store and the toy joint venture be worth anywhere near $2.7 billion? Let's look at how these businesses have fared to date.

Amazon opened its toy store in July 1999. In the fourth quarter of 1999, the company was forced to write off $39 million of inventory (presumably most of it in overstocked toys). In August 2000, Amazon and Toysrus.com announced a joint venture, in which AMZN would be responsible for the co-branded Web site and its development, as well as product warehousing, fulfillment, and shipping. Toysrus.com would be responsible for merchandising, product purchases, and inventory management. Amazon also opened its consumer electronics store in July 1999. In August 2000, AMZN announced that this store was its second-largest revenue generator (after books), ahead of its more mature music and video stores.

What Is The Toy Partnership Worth? It is difficult to place a value on Amazon's toy partnership with Toysrus.com because neither company will disclose its terms. However, Amazon's fourth-quarter results helped us to understand the basics of the deal. AMZN has stated that it receives four streams of revenue: a fixed annual payment, a flat fee per item, a percentage of gross revenue, and all shipping revenue. Toys "R" Us stated that its online sales during the nine-week holiday season was $124 million, and estimated sales for the three months ended December 31, 2000, at approximately $150 million. Of this, we estimate that Amazon received $34 million in revenue (excluding shipping and a $9 million inventory sale to TOY), and $12 million in gross profit. We don't know how much, if any, of AMZN's "early-stage businesses" segment operating expense applied to toys, but even if we assume none of it did, we estimate the net after-tax operating profit contribution from this partnership at a miniscule $7 million.

Even if we assume TOY can grow online revenue at more than 30% for the next six years and achieve $750 million by 2006, and if we assume TOY would give AMZN operating profits of 3% of gross sales (TOY's five-year average operating margin is only 6.3%), it would only amount to net income of $23 million. Capitalized at 30 times forward earnings and discounted back at 20%, we estimate the toy category may potentially have a present value of little more than $270 million, even though our assumptions for future sales growth and AMZN's share of the spoils seem fairly aggressive.

So What's The Value Of The Consumer Electronics (C/E) Business? We can't exactly dissect the performance of Amazon's consumer electronics store, since the company discloses C/E results as part of its early-stage businesses segment. However, we are able to approximate results in this store through supplemental disclosures. If we deduct advertising/fee-based revenue and gross profit from AMZN's early-stage businesses segment, we are left with results from the consumer electronics store, along with smaller product categories such as home improvement, lawn and garden, and kitchen. We estimate that these product categories contributed $242 million in revenue and $20 million in gross profit in fourth-quarter 2000. Therefore, we believe that C/E's gross margin contribution could only have been 8.3%, at best.

Furthermore, we know that Amazon's company-wide fulfillment costs amounted to 15% of product revenue in the quarter, so if we apply this rate to consumer electronics, we find that AMZN's contribution margin in C/E (which we define as gross profit less fulfillment cost as a percentage of revenue) was negative 7%. In other words, it cost Amazon a minimum of $1.07 for every $1.00 of C/E revenue. In addition, segment operating expenses added another $0.32 to the loss, meaning that Amazon lost $1.39 for every $1.00 of product revenue in the segment.

We find it hard to believe that this segment could be rationally valued at anywhere close to the $2.3 billion gap between firm value and our global B/M/V, toy and "other" segment value estimate. Consumer electronics is a notoriously difficult business, and pure-play online consumer electronics retailers have found profitability elusive. The current market capitalizations of Outpost.com (COOL—$1.31, not rated), Buy.com (BUYX—$0.63, not rated), and Egghead (EGGS—$0.81, not rated) are approximately $41 million, $84 million, and $39 million, respectively. Each of these firms has built rather substantial, but money-losing, Internet-based consumer electronics businesses with expected revenue of more than $500 million per year, yet the market value of each is at only approximately 0.1 times forward revenue. While some would argue that Amazon's C/E business is more attractive than those of its competitors, we believe it is only marginally more so.

Add It All Up, And What Have You Got? Based on our sum-of-the-parts analysis, we estimate that Amazon's present firm value is approximately $8 per share. Of course, many assumptions are incorporated into this valuation, some or all of which may prove erroneous. Yet despite the drawbacks inherent in this type of analysis, we believe it does point to significant risk for AMZN shareholders, if the assumptions prove correct.

Discounted Cash Flow Analysis. We also tried to assess AMZN's present equity value through a series of company-wide discounted cash earnings analyses. In Figures 3-5, we illustrate three discounted cash flow analyses of AMZN, portraying what we believe to be a best case, a worst case, and a middle-of-the-road scenario. We leave it to investors to decide for themselves what the future may hold, but in our view, the latter is the most likely outcome. In the sections below, we describe the methodology and resulting valuation parameters for each scenario.

Our Middle-Of-The-Road Scenario Reveals A Lower Firm Value... This scenario is illustrated in Figure 3. For this analysis, we based AMZN's long-term growth and profitability on historical results from a select group of traditional retailers that have, to date, survived the competitive wars (Figure 6).

Our assumptions include revenue of more than $8.6 billion by full-year 2006, equating to an impressive but not incomprehensible CAGR of 20.8% through 2006. In addition, we assume steadily improving operating profit margins, reaching a rather typical (at least for traditional retailers) 6% company-wide operating margin by 2006. This translates into operating at break-even in full-year 2003, and EPS reaching $0.87 in full-year 2006 (assuming no further equity dilution). Based on these assumptions, we utilize a P/E multiple sensitivity analysis to arrive at an estimated range for AMZN's value. Finally, we use a 20% discount rate on the future earnings in order to compensate investors for the risk inherent in AMZN's model.

We estimate that AMZN could be worth anywhere from $2.83 to $11.56 per share, based on a P/E multiple range of 15-40 times, with the most likely range, in our opinion, between $6.32 and $9.82.

...But The Best-Case Scenario Could Be Its Undoing. Clearly, with the market placing a $14.44 value on AMZN shares, our middle-of-the-road valuation analysis could be mistaken. Thus, we show in Figure 4 a DCF analysis with what we consider to be a best-case scenario, which portrays the bull case for AMZN. As this analysis reveals, we estimate that the present value of AMZN shares could be as high as $62; however, we note that the assumptions needed to reach this valuation level are extremely aggressive, and unlikely to pan out.

The assumptions we use in this best-case scenario include revenue of more than $12 billion in 2006, equating to a CAGR of 28% through 2006. In addition, we assume steadily improving operating profit margins, reaching an impressive 10% company-wide by 2006. This translates into a full-year 2001 loss per share of $0.31 (versus our current LPS estimate of $0.92), break-even in full-year 2002 (versus our current LPS estimate of $0.55), and rapidly increasing EPS, reaching $2.05 in full-year 2006 (assuming no further equity dilution). Based on these assumptions, we utilize a P/E multiple sensitivity analysis to arrive at an estimated range of AMZN's value. Finally, we use an 18% discount rate in this scenario, 200 basis points lower than our preferred 20% rate for Internet retailers (although higher than the 15% rate we used earlier for Amazon's B/M/V segment alone).

As detailed at the bottom of Figure 4, using our best-case assumptions, we estimate that AMZN's present value could be worth anywhere from $17.30 to $62.13 per share, based on a P/E multiple range of 20-70 times.

However, The Worst-Case Scenario Shows That Complete Loss Of Equity Value Is A Possibility. Just as it is possible to paint a bullish, best-case scenario for AMZN, it is also possible to paint a bearish, worst-case scenario. In this scenario, growth falters, operating break-even is achieved but within a longer-than-expected time frame, and operating margins ultimately max out at a lower-than-expected level. In this scenario, as detailed in Figure 5, AMZN shares have little if any present equity value.

The assumptions we use in this worst-case scenario include revenue of just $5.7 billion in 2006, equating to a CAGR of 12.7% through 2006. We note that, as illustrated in Figure 6, this growth rate is in line with the mean and median five-year average growth rates for our select group of traditional retailers. In addition, while we continue to assume an improving operating profit/(loss) margin, AMZN doesn't achieve company-wide break-even in this scenario until full-year 2004, and ultimately, in the final year of the analysis, achieves a meager operating margin of 4%. This translates into EPS reaching just $0.38 in full-year 2006 (assuming no further equity dilution). Based on all of these input assumptions, we utilize a P/E multiple sensitivity analysis to arrive at an estimated range for AMZN's value. Finally, in this scenario, we use a 22% discount rate on future earnings, 200 basis points higher than our preferred 20% rate for Internet retailers, as investors contemplating a worst-case scenario would naturally expect a higher rate of return.

As detailed in Figure 5, using our worst-case assumptions, we estimate that AMZN could be worth anywhere from $(1.16) to $2.38 per share, based on a P/E multiple range of 15-40 times. If this worst-case scenario were to play out, then equity investors in AMZN would have little to no value, in our view.

The Balance Sheet Debate Rages On. In several reports focused on Amazon's convertible debt, an analyst from a competing firm questioned the company's ability to continue as a going concern. In a recent report, this analyst essentially contended that AMZN's working capital will continue to deteriorate, causing its trade creditors to tighten credit restrictions, resulting in a working capital crunch. We find ourselves in the odd position of defending a company whose rating we are downgrading to Sell!

While the future scenario in our competitor's report is certainly possible, we believe it is rather unlikely. In Figures 8 and 9, we show the historical and projected cash flow statement and balance sheet for Amazon. In our opinion, the history of retail shows that retailers generally experience cash flow and working capital problems when they commit to inventory that they are later unable to sell. This scenario can quickly lead to a cash crunch, even at well-managed retailers.

However, since Amazon off-loaded toy inventory risk to Toys "R" Us, it has extremely low inventory risk exposure. For the most part, inventory risk in the book, music, and video categories is taken by the publisher, not the retailer; thus, Amazon could return unsold items for credit at the end of the season, if necessary. In addition, it now has little, if any, inventory risk in toys. Therefore, the only product category of any size in which Amazon has significant inventory risk is consumer electronics. And in our experience, we've found that relatively fresh consumer electronics inventory can be sold at a small discount, if necessary, so inventory risk here is unlikely to precipitate a cash crisis for Amazon.

If inventory risk is unlikely to cause a cash crisis at AMZN, the other areas of concern might be capital expenditures and operating losses. In our view, the heaviest period of capital expenditures is behind the company, with a large infrastructure already in place, as evidenced by the projected $120 million in capital expenditures for full-year 2001. And finally, unless a long, deep recession occurs, we believe Amazon will have enough cash to fund operating losses at least through the end of 2002.

In conclusion, we believe that a rational valuation approach to AMZN reveals significant downside risk to equity holders. In our opinion, the risk outweighs the upside potential. Therefore, we are lowering our rating on AMZN to Sell (from Hold) and our price target to $9 (from $20).

Figure 1. We Estimate AMZN's B/M/V Segment May Be Worth Roughly 50% Of Firm Value

	Revenue At Maturity	Operating Margin	Operating Income	After Tax Operating Income	Price/Earnings Capitalization	Value
U.S. and int'l B/M/V segment	4,000,000	7.5%	300,000			
Advertising contribution	123,711	2.7%	111,340			
Estimated future value, 5 years out	4,123,711	10.0%	411,340	246,804	25	6,170,103
Discount rate						15%
Estimated present value of global B/M/V						**3,067,632**
Value per share						**8.62**
AMZN market capitalization						4,801,694
Plus debt as of 12/31/00						2,127,464
(Less) cash as of 12/31/00						(1,100,522)
AMZN Firm value						5,828,636
Less global B/M/V firm value						(3,067,632)
Firm value, excluding global B/M/V						**2,761,004**
Firm value per share, excluding global B/M/V						**7.76**
Shares outstanding						355,681
Current AMZN price per share						13.50

Source: Company reports and Prudential Securities estimates.

Figure 2. A Sum-Of-The-Parts Analysis Reveals Significant Downside Risk In AMZN

Product Category	Value ($ in 000s)
Global books, music, video, advertising	3,067,632
Toys	271,267
Electronics	400,000
Other	100,000
(Less) current debt	(2,127,464)
Plus current cash	1,100,522
Sum-Of-The-Parts Value	**2,811,957**
Sum-Of-The-Parts Value-Per-Share	**7.91**

Source: Company reports and Prudential Securities estimates.

Figure 3. Discounted Cash Earnings Analysis—Middle-Of-The-Road Scenario

($ in millions, except per share data)	2001E	2002E	2003E	2004E	2005E	2006E
Revenue	3,490.5	4,447.8	5,559.8	6,671.8	7,672.5	8,593.2
Gross Profit	810.6	1,112.0	1,832.3	2,378.4	2,907.0	3,403.8
Operating Expense, ex non-cash	1,020.1	1,220.7	1,691.3	1,938.0	2,061.3	2,188.2
Operating Profit	(209.5)	(108.7)	111.2	200.2	306.9	515.6
Provision for taxes	-	-	-	-	-	206.2
Net income/(loss)	(336.0)	(208.7)	111.2	200.2	306.9	309.4
Cash EPS/(LPS)	($0.92)	($0.55)	$0.40	$1.24	$2.38	$2.05

Assumptions

Revenue Growth	26%	27%	25%	20%	15%	12%
Implied Five-Year CAGR						20.8%
Gross Margin	23.2%	25.0%	33.0%	26.0%	27.0%	28.0%
Operating Expense	29.2%	27.4%	30.4%	29.0%	26.9%	25.5%
Operating Profit Margin	-6.0%	-2.4%	2.0%	3.0%	4.0%	6.0%
Tax Rate	0%	0%	0%	0%	0%	40%

Firm Value/Net Income Sensitivity Analysis

($ in millions, except per share data)

Firm Value/Net income	15	20	25	30	35	40
Estimated future firm value	4,640.3	6,187.1	7,733.9	9,280.7	10,827.5	12,374.3
Discount rate	20%	20%	20%	20%	20%	20%
Estimated present firm value	1,864.9	2,486.5	3,108.1	3,729.7	4,351.3	4,972.9
Long-term debt less cash	1,026.9	1,026.9	1,026.9	1,026.9	1,026.9	1,026.9
Plus PV of estimated income 2001-2005	167.1	167.1	167.1	167.1	167.1	167.1
Estimated present value of equity	1,005.0	1,626.6	2,248.2	2,869.9	3,491.5	4,113.1
Shares outstanding	355.7	355.7	355.7	355.7	355.7	355.7
Value per share	$2.83	$4.57	$6.32	$8.07	$9.82	$11.56

*Assumes depreciation equals capital expenditures.

Source: Prudential Securities estimates.

Figure 4. Discounted Cash Flow Analysis—Best-Case Scenario

($ in millions, except per share data)	2001E	2002E	2003E	2004E	2005E	2006E
Revenue	3,728.7	5,220.1	7,047.2	8,809.0	10,570.8	12,156.4
Gross Profit	857.6	1,305.0	1,832.3	2,378.4	2,907.0	3,403.8
Operating Expense, ex non-cash	969.5	1,305.0	1,691.3	1,938.0	2,061.3	2,188.2
Operating Profit	(111.9)	0.0	140.9	440.4	845.7	1,215.6
Provision for taxes	-	-	-	-	-	486.3
Net income/(loss)	(111.9)	0.0	140.9	440.4	845.7	729.4
Cash EPS/(LPS)	($0.31)	$0.00	$0.40	$1.24	$2.38	$2.05

Assumptions						
Revenue Growth	35%	40%	35%	25%	20%	15%
Implied Five-Year CAGR						28.0%
Gross Margin	23.0%	25.0%	26.0%	27.0%	27.5%	28.0%
Operating Expense	26.0%	25.0%	24.0%	22.0%	19.5%	18.0%
Operating Profit Margin	-3.0%	0.0%	2.0%	5.0%	8.0%	10.0%
Tax Rate	0%	0%	0%	0%	0%	40%

Firm Value/Net Income Sensitivity Analysis

($ in millions, except per share data)

Firm Value/Net income	20	30	40	50	60	70
Estimated future firm value	14,587.7	21,881.6	29,175.4	36,469.3	43,763.1	51,057.0
Discount rate	18%	18%	18%	18%	18%	18%
Estimated present firm value	6,376.4	9,564.6	12,752.8	15,941.0	19,129.3	22,317.5
Long-term debt less cash	1,026.9	1,026.9	1,026.9	1,026.9	1,026.9	1,026.9
Plus PV of estimated income 2001-2005	805.5	805.5	805.5	805.5	805.5	805.5
Estimated present value of equity	6,155.0	9,343.2	12,531.4	15,719.6	18,907.8	22,096.0
Shares outstanding	355.7	355.7	355.7	355.7	355.7	355.7
Value per share	$17.30	$26.27	$35.23	$44.20	$53.16	$62.12

*Assumes depreciation equals capital expenditures.

Source: Prudential Securities estimates.

Figure 5. Discounted Cash Flow Analysis—Worst-Case Scenario

($ in millions, except per share data)	2001E	2002E	2003E	2004E	2005E	2006E
Revenue	3,200.0	3,840.0	4,416.0	4,945.9	5,391.1	5,660.6
Gross Profit	736.0	883.2	1,015.7	1,137.6	1,239.9	1,301.9
Operating Expense, ex non-cash	1,056.0	1,075.2	1,059.8	1,137.6	1,132.1	1,075.5
Operating Profit	(320.0)	(192.0)	(44.2)	0.0	107.8	226.4
Provision for taxes	-	-	-	-	-	90.6
Net income/(loss)	(320.0)	(192.0)	(44.2)	0.0	107.8	135.9
Cash EPS/(LPS)	($0.90)	($0.54)	($0.12)	$0.00	$0.30	$0.38

Assumptions						
Revenue Growth	16%	20%	15%	12%	9%	5%
Implied Five-Year CAGR						12.7%
Gross Margin	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%
Operating Expense	33.0%	28.0%	24.0%	23.0%	21.0%	19.0%
Operating Profit Margin	-10.0%	-5.0%	-1.0%	0.0%	2.0%	4.0%
Tax Rate	0%	0%	0%	0%	0%	40%

Firm Value/Net Income Sensitivity Analysis

($ in millions, except per share data)

Firm Value/Net income	15	20	25	30	35	40
Estimated future firm value	2,037.8	2,717.1	3,396.4	4,075.6	4,754.9	5,434.2
Discount rate	22%	22%	22%	22%	22%	22%
Estimated present firm value	754.0	1,005.3	1,256.7	1,508.0	1,759.3	2,010.6
Long-term debt less cash	1,026.9	1,026.9	1,026.9	1,026.9	1,026.9	1,026.9
Plus PV of estimated income 2001-2005	(138.4)	(138.4)	(138.4)	(138.4)	(138.4)	(138.4)
Estimated present value of equity	(411.3)	(160.0)	91.3	342.7	594.0	845.3
Shares outstanding	355.7	355.7	355.7	355.7	355.7	355.7
Value per share	($1.16)	($0.45)	$0.26	$0.96	$1.67	$2.38

*Assumes depreciation equals capital expenditures.

Source: Prudential Securities estimates.

Figure 6. Comparable Metrics From Traditional Retailers

All data as of 2/7/01	Price/ First Call Mean EPS FY1	5Yr Avg Basic P/E	Price/ Sales	5 Yr Avg Price/ Sales	5Yr Avg Gross Income Margin	5 Year Average Operating Margin	5Yr Avg Net Income Margin	5 Year Net Sales Growth
WAL-MART STORES	38.8x	32.6x	1.3x	1.0x	20.8%	4.6%	3.1%	14.5%
K MART CORP	18.8x	18.2x	0.1x	0.2x	22.0%	2.5%	0.7%	0.5%
TARGET CORP	26.9x	22.9x	0.9x	0.6x	23.6%	5.8%	2.5%	9.6%
BEST BUY CO INC	24.8x	74.3x	0.6x	0.4x	16.0%	2.5%	1.3%	17.3%
CIRCUIT CITY STR CRCT CTY GP	23.7x	28.7x	0.3x	0.5x	24.2%	3.9%	2.1%	12.6%
SEARS ROEBUCK & CO	8.1x	14.3x	0.3x	0.4x	32.6%	9.0%	3.1%	(2.4%)
PENNEY (J C) CO	64.2x	105.1x	0.1x	0.4x	27.4%	5.6%	2.2%	10.0%
GAP INC	29.0x	29.3x	1.9x	2.4x	39.0%	14.0%	8.7%	25.9%
FEDERATED DEPT STORES	15.2x	24.8x	0.5x	0.5x	39.2%	8.1%	2.9%	11.7%
MAY DEPARTMENT STORES CO	15.2x	15.3x	0.9x	0.9x	31.5%	12.6%	6.3%	4.1%
DILLARDS INC -CL A	19.7x	17.1x	0.2x	0.5x	31.6%	7.4%	2.8%	9.2%
NORDSTROM INC	19.7x	22.0x	0.5x	0.8x	34.1%	7.1%	3.8%	5.9%
COSTCO WHOLESALE CORP	31.9x	27.0x	0.6x	0.5x	11.8%	3.0%	1.7%	12.0%
KOHLS CORP	64.1x	46.3x	4.1x	1.8x	31.3%	8.6%	4.7%	24.1%
TOYS R US INC	26.7x	24.3x	0.5x	0.6x	27.3%	6.3%	2.3%	6.3%
BARNES & NOBLE INC	23.7x	24.7x	0.4x	0.6x	28.6%	5.4%	1.7%	16.1%
BORDERS GROUP INC	12.8x	20.5x	0.4x	0.7x	27.2%	5.4%	0.2%	14.6%
COMPUSA INC	N/A	34.7x	N/A	0.3x	13.5%	2.0%	0.8%	23.6%
TRANS WORLD ENTMT CORP	8.8x	15.6x	0.4x	0.4x	34.0%	6.5%	2.1%	17.7%
SPIEGEL INC -CL A	8.0x	57.5x	0.3x	0.2x	38.7%	2.9%	0.2%	0.3%
AMAZON.COM INC	N/A	N/A	1.9x	16.7x	16.2%	(34.2%)	(35.8%)	N/A
MEAN (excluding AMZN)	**25.3x**	**32.8x**	**0.8x**	**0.7x**	**27.7%**	**6.2%**	**2.7%**	**11.7%**
MEDIAN (excluding AMZN)	23.7x	24.7x	0.5x	0.5x	28.0%	5.7%	2.2%	11.9%
HIGH (excluding AMZN)	64.2x	105.1x	4.1x	2.4x	39.2%	14.0%	8.7%	25.9%
LOW (excluding AMZN)	8.0x	14.3x	0.1x	0.2x	11.8%	2.0%	0.2%	(2.4%)

Source: First Call and Prudential Securities estimates.

Figure 7. AMZN Income Statement

	2000				2001						
	March	**June**	**Sept.**	**Dec.**	**March E**	**June E**	**Sept. E**	**Dec. E**	**1999**	**2000**	**2001E**
U.S. book, music and video segment revenue	401,415	385,275	399,905	511,671	441,557	423,803	439,896	614,005	1,308,292	1,698,266	1,919,261
International segment revenue	75,132	73,393	87,665	144,885	112,698	110,090	131,498	231,816	167,743	381,075	586,102
Total early stage business and other segment	97,342	119,208	150,288	315,804	120,065	147,170	205,018	512,900	163,804	682,642	985,153
Net revenue	**573,889**	**577,876**	**637,858**	**972,360**	**674,320**	**681,063**	**776,412**	**1,358,721**	**1,639,839**	**2,761,983**	**3,490,516**
Cost of revenue	445,755	441,812	470,579	748,060	522,598	521,013	590,073	1,046,215	1,349,194	2,106,206	2,679,899
Gross profit	**128,134**	**136,064**	**167,279**	**224,300**	**151,722**	**160,050**	**186,339**	**312,506**	**290,645**	**655,777**	**810,617**
Operating expenses											
Advertising portion of marketing	40,611	42,213	41,942	55,223	40,102	42,616	50,503	51,384	174,783	179,989	184,606
Fulfillment & other sales marketing	99,500	87,600	96,400	131,000	94,405	91,944	104,816	149,459	238,367	414,500	440,623
Total sales and marketing	140,111	129,813	138,342	186,223	134,507	134,560	155,319	200,843	413,150	594,489	625,229
Product development	61,244	67,132	71,159	69,791	69,818	72,611	72,974	75,163	159,722	269,326	290,566
General and administrative	26,045	28,468	26,217	28,232	25,254	25,507	26,527	27,058	70,144	108,962	104,346
Goodwill amortization, and m&a related costs	82,955	80,413	79,194	79,210	68,803	68,803	68,803	68,803	214,694	321,772	275,212
Stock based compensation	13,652	8,166	4,091	(1,112)	4,000	4,000	4,000	4,000	30,618	24,797	16,000
Merger, acquisition & investment costs	2,019	2,449	11,791	184,052	2,500	2,500	2,500	2,500	8,072	200,311	10,000
Total operating expenses	326,026	316,441	330,794	546,396	304,882	307,981	330,123	378,367	896,400	1,519,657	1,321,353
Loss from operations	**(197,892)**	**(180,377)**	**(163,515)**	**(322,096)**	**(153,160)**	**(147,931)**	**(143,784)**	**(65,861)**	**(605,755)**	**(863,880)**	**(510,736)**
Loss from operations, ex non-cash	**(99,266)**	**(89,349)**	**(68,439)**	**(59,946)**	**(77,857)**	**(72,628)**	**(68,481)**	**9,442**	**(352,371)**	**(317,000)**	**(209,524)**
Net interest income (expense)	(17,495)	(23,083)	(24,407)	(25,115)	(26,500)	(28,000)	(29,500)	(30,500)	(39,115)	(90,100)	(114,500)
Other income/(expense)	(4,774)	(3,272)	3,353	(5,365)	(3,000)	(3,000)	(3,000)	(3,000)	1,671	(10,058)	(12,000)
Noncash investment gains/(losses)			12,366	(155,005)	-	-	-	-		(142,639)	-
Earnings before taxes	**(220,161)**	**(206,732)**	**(172,203)**	**(507,581)**	**(182,660)**	**(178,931)**	**(176,284)**	**(99,361)**	**(643,199)**	**(1,106,677)**	**(637,236)**
Equity in losses of equity method investees	(88,264)	(110,452)	(68,321)	(37,559)	(25,000)	(25,000)	(25,000)	(25,000)	(76,769)	(304,596)	(100,000)
Taxes	-	-	-	-	-	-	-	-	-	-	-
Net income/(loss)	**(308,425)**	**(317,184)**	**(240,524)**	**(545,140)**	**(207,660)**	**(203,931)**	**(201,284)**	**(124,361)**	**(719,968)**	**(1,411,273)**	**(737,236)**
Basic and diluted (loss) per share	**($0.90)**	**($0.91)**	**($0.68)**	**($1.53)**	**($0.57)**	**($0.56)**	**($0.55)**	**($0.34)**	**($2.20)**	**($4.02)**	**($2.02)**
Net income/(loss) ex m&a, goodwill	**(121,535)**	**(115,704)**	**(89,493)**	**(90,426)**	**(107,357)**	**(103,628)**	**(100,981)**	**(24,058)**	**(389,815)**	**(417,158)**	**(336,024)**
Basic and diluted (loss) per share	**($0.35)**	**($0.33)**	**($0.25)**	**($0.25)**	**($0.30)**	**($0.28)**	**($0.28)**	**($0.07)**	**($1.19)**	**($1.19)**	**($0.92)**
Basic and diluted shares outstanding	343,884	349,886	353,954	355,681	361,886	364,886	366,886	368,886	326,753	350,873	365,636
Year/year change in revenue (%)	95.4%	83.8%	79.3%	43.8%	17.5%	17.9%	21.7%	39.7%	169%	68%	26%
Year/year change in U.S. book, music, video	50.0%	37.8%	32.7%	11.3%	10.0%	10.0%	10.0%	20.0%	122%	30%	13%
Year/year change in international revenue	192.1%	137.3%	115.8%	104.1%	50.0%	48.0%	53.6%	60.0%	669%	127%	54%
Year/year change in new business categories	24114.4%	3366.4%	916.3%	117.5%	23.3%	23.5%	36.4%	62.4%	NM	317%	44%
Gross margin	22.3%	23.5%	26.2%	23.1%	22.5%	23.5%	24.0%	23.0%	17.7%	23.7%	23.2%
Gross margin on product sales	19.7%	17.7%	20.0%	20.7%	18.3%	19.4%	19.9%	16.6%	12.7%	18.3%	18.2%
Fulfillment costs as a % of revenue	17.3%	15.2%	15.1%	13.5%	14.0%	13.5%	13.5%	11.0%	14.5%	15.0%	12.6%
Contribution margin (gm less fulfillment)	5.0%	8.4%	11.1%	9.6%	8.5%	10.0%	10.5%	12.0%	3.2%	8.7%	10.6%
Operating margin, ex noncash	-17.3%	-15.5%	-10.7%	-6.2%	-11.5%	-10.7%	-8.8%	0.7%	-21.5%	-11.5%	-6.0%
Net margin, ex noncash	-21.2%	-20.0%	-14.0%	-9.3%	-15.9%	-15.2%	-13.0%	-1.8%	-23.8%	-15.1%	-9.6%
Advertising as a % of revenue	7.1%	7.3%	6.6%	5.7%	5.9%	6.3%	6.5%	3.8%	10.7%	6.5%	5.3%
Product development as a % of revenue	10.7%	11.6%	11.2%	7.2%	10.4%	10.7%	9.4%	5.5%	9.7%	9.8%	8.3%
G&A as a % of revenue	4.5%	4.9%	4.1%	2.9%	3.7%	3.7%	3.4%	2.0%	4.3%	3.9%	3.0%
Tax rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company reports and Prudential Securities estimates.

Figure 8. AMZN Cash Flow Statement

	2000				2001						
	March	**June**	**Sept.**	**Dec.**	**March E**	**June E**	**Sept. E**	**Dec. E**	**1999**	**2000**	**2001E**
Net loss	(308,425)	(317,184)	(240,524)	(545,140)	(207,660)	(203,931)	(201,284)	(124,361)	(719,968)	(1,411,273)	(737,236)
Depreciation and amortization of fixed assets	18,180	20,682	22,857	22,741	23,515	26,575	29,635	32,695	36,806	84,460	112,420
Amortization of unearned compensation	13,652	8,166	4,091	(1,112)	4,000	4,000	4,000	4,000	30,618	24,797	16,000
Equity in losses of equity-method investees	88,264	110,452	68,321	37,559	25,000	25,000	25,000	25,000	76,769	304,596	100,000
Amortiztion of goodwill and other intangibles	82,955	80,413	79,194	79,210	68,803	68,803	68,803	68,803	222,766	321,772	275,212
Impairment related and other	2,019	2,449	11,791	184,052	2,500	2,500	2,500	2,500	-	200,311	10,000
Unearned Revenue	614	(411)	57,466	31,727	15,000	15,000	15,000	15,000		89,396	60,000
Amortization of previously unearned revenue	(18,485)	(18,781)	(26,870)	(42,653)	(5,000)	(20,000)	(5,000)	(30,000)	-	(106,789)	(60,000)
Non-cash revenue for adv. & promo. services	-	-	-	-	-	-	-	-	(5,837)	-	-
Loss on sale of marketable securities	(2,600)	1,648	(3,205)	3,877	-	-	-	-	8,688	(280)	-
Non-cash investment gains and losses, net	-	-	(12,366)	155,005	-	-	-	-		142,639	-
Noncash interest expense	5,745	(9,962)	6,227	6,450	36,500	37,000	37,500	38,000	29,171	8,460	149,000
Changes in operating assets and liabilities											
Inventories	48,389	(103)	8,480	(10,683)	(8,346)	555	(24,171)	(55,028)	(172,069)	46,083	(86,991)
Prepaid expenses and other current assets	2,634	4,104	(6,034)	3,412	(1,196)	(1,178)	(8,414)	(18,333)	(60,628)	4,116	(29,120)
Deposits and other	-	-	-	-	-	-	-	-	-	-	-
Accounts payable	(207,229)	30,442	18,470	180,674	(190,414)	40,438	60,440	313,844	330,166	22,357	224,307
Interest payable	(8,988)	18,642	(4,473)	29,160	-	-	-	-	24,878	34,341	-
Accrued advertising	-	-	-	-	-	-	-	-	42,382	-	-
Other liabilities and accrued expenses	(37,239)	(756)	12,887	113,374	(146,415)	1,704	12,178	162,913	65,383	88,266	30,381
Changes in operating assets and liabilities	(202,433)	52,329	29,330	315,937	(346,371)	41,519	40,033	403,396	230,112	195,163	138,577
Cash flow from operations	**(320,514)**	**(70,199)**	**(3,688)**	**247,653**	**(383,713)**	**(3,534)**	**16,187**	**435,033**	**(90,875)**	**(146,748)**	**63,972**
Maturities of marketable securities	1,013,947	(564,653)	72,619	23,811	-	-	-	-	2,064,101	545,724	-
Purchases of marketable securities	(1,333,393)	1,282,607	(44,954)	(88,715)	-	-	-	-	(2,359,398)	(184,455)	-
Purchases of fixed assets	(26,601)	(28,878)	(41,948)	(37,331)	(30,000)	(30,000)	(30,000)	(30,000)	(287,055)	(134,758)	(120,000)
Investment in equity method investees & othe	(47,487)	(8,595)	(5,760)	(691)	-	-	-	-	(369,607)	(62,533)	-
Cash flow from investment	**(393,534)**	**680,481**	**(20,043)**	**(102,926)**	**(30,000)**	**(30,000)**	**(30,000)**	**(30,000)**	**(951,959)**	**163,978**	**(120,000)**
Proceeds from initial public offering	-	-	-	-	-	-	-	-	-	-	-
Proceeds - ex. stock options & sale cap. sto	21,359	13,794	4,564	4,980	-	-	-	-	64,469	44,697	-
Proceeds from sale of capital stock	-	-	-	-	-	-	-	-	-	-	-
Proceeds from long-term debt	679,374	1,625	500	-	-	-	-	-	1,263,639	681,499	-
Repayment of debt	(4,023)	(5,197)	(3,777)	(3,930)	-	-	-	-	(188,886)	(16,927)	-
Financing costs related to debt issuance	(15,895)	(227)	-	-	-	-	-	-	(35,151)	(16,122)	-
Cash flow from financing	**680,815**	**9,995**	**1,287**	**1,050**	**-**	**-**	**-**	**-**	**1,104,071**	**693,147**	**-**
Effect of exchange rate changes	358	(334)	(50,885)	29,610	-	-	-	-	489	(21,251)	-
Net increase/(decrease) in cash	**(32,875)**	**619,943**	**(73,329)**	**175,387**	**(413,713)**	**(33,534)**	**(13,813)**	**405,033**	**61,726**	**689,126**	**(56,028)**
Cash at beginning of period	133,309	100,434	720,377	647,048	822,435	408,722	375,188	361,375	71,583	133,309	822,435
Cash at end of period	100,434	720,377	647,048	822,435	408,722	375,188	361,375	766,407	133,309	822,435	766,407

Source: Company reports and Prudential Securities estimates.

Prudential Securities

Figure 9. AMZN Balance Sheet

	2000				2001						
	March	June	Sept.	Dec.	March E	June E	Sept. E	Dec. E	1999	2000	2001E
ASSETS											
Cash	84,087	720,377	647,048	822,435	408,722	375,188	361,375	766,407	133,309	822,435	766,407
Marketable securities	924,794	187,244	252,976	278,087	278,087	278,087	278,087	278,087	572,879	278,087	278,087
Inventories	172,257	172,360	163,880	174,563	182,909	182,355	206,526	261,554	220,646	174,563	261,554
Prepaid expenses and other	89,811	86,659	99,181	86,044	87,240	88,418	96,832	115,164	79,643	86,044	115,164
Total current assets	**1,270,949**	**1,166,640**	**1,163,085**	**1,361,129**	**956,958**	**924,047**	**942,819**	**1,421,213**	**1,006,477**	**1,361,129**	**1,421,213**
									-		
Fixed assets (net)	334,396	344,042	352,290	366,416	417,416	468,416	519,416	570,416	317,613	366,416	570,416
Goodwill and other intangibles (net)	471,748	441,240	383,996	158,990	90,187	21,384	-	-	534,699	158,990	-
Other purchased intangibles, net	175,444	155,538	136,474	96,335	96,335	96,335	96,335	96,335	195,445	96,335	96,335
Investments in equity method investees	271,542	211,715	91,131	52,073	52,073	52,073	52,073	52,073	226,727	52,073	52,073
Deposits and other investments	150,782	88,261	73,345	40,177	40,177	40,177	40,177	40,177	144,735	40,177	40,177
Other assets	54,882	53,294	54,306	60,049	58,049	56,049	54,049	52,049	40,154	60,049	52,049
Total non-current assets	**1,458,794**	**1,294,090**	**1,091,542**	**774,040**	**754,237**	**734,434**	**762,050**	**811,050**	**1,459,373**	**774,040**	**811,050**
Total Assets	**2,729,743**	**2,460,730**	**2,254,627**	**2,135,169**	**1,711,195**	**1,658,481**	**1,704,869**	**2,232,263**	**2,465,850**	**2,135,169**	**2,232,263**
									-		
LIABILITIES AND STOCKHOLDERS' EQUITY									-		
Accounts payable	255,797	286,239	304,709	485,383	294,969	335,407	395,846	709,690	463,026	485,383	709,690
Other liabilities and accrued expenses	115,811	146,874	160,073	272,683	126,268	127,973	140,151	303,064	176,208	272,683	303,064
Unearned revenue	134,758	115,566	142,046	131,117	131,117	131,117	131,117	131,117	54,790	131,117	131,117
Accrued advertising	29,004	-	-	-	-	-	-	-	-	-	-
Accrued product development	-	-	-	-	-	-	-	-	-	-	-
Interest payable	15,812	41,213	35,056	69,196	69,196	69,196	69,196	69,196	24,888	69,196	69,196
Current portion of long-term debt	15,983	17,731	17,213	16,577	14,987	15,003	15,019	15,035	14,322	16,577	15,035
Total current liabilities	**567,165**	**607,623**	**659,097**	**974,956**	**636,537**	**678,696**	**751,329**	**1,228,102**	**733,234**	**974,956**	**1,228,102**
									-		
Long-term debt	2,136,961	2,131,531	2,082,697	2,127,464	2,140,995	2,143,286	2,145,531	2,147,801	1,466,338	2,127,464	2,147,801
Long-term portion of capital lease obligation	-	-	-	-	-	-	-	-	-	-	-
Total long term liabilities	**2,136,961**	**2,131,531**	**2,082,697**	**2,127,464**	**2,140,995**	**2,143,286**	**2,145,531**	**2,147,801**	**1,466,338**	**2,127,464**	**2,147,801**
Total Liabilities	**2,704,126**	**2,739,154**	**2,741,794**	**3,102,420**	**2,777,533**	**2,821,982**	**2,896,860**	**3,375,903**	**2,199,572**	**3,102,420**	**3,375,903**
									-		
Total stockholders' equity	**25,617**	**(278,424)**	**(487,167)**	**(967,251)**	**(1,066,337)**	**(1,163,500)**	**(1,191,991)**	**(1,143,641)**	**266,278**	**(967,251)**	**(1,143,641)**
									-		
Total liabilities and stockholders' equi	**2,729,743**	**2,460,730**	**2,254,627**	**2,135,169**	**1,711,195**	**1,658,481**	**1,704,869**	**2,232,263**	**2,465,850**	**2,135,169**	**2,232,263**
RATIOS											
Inventory Turns	9.1	10.3	11.2	17.7	11.7	11.4	12.1	17.9	10.8	10.7	12.3
Days Inventory Held	40	36	33	21	31	32	30	20	34	34	30
Accounts Payable Turnover	1.1	1.6	1.6	1.9	1.4	1.7	1.7	2.0	5.3	4.3	4.6
Days Accounts Payable Outstanding	83	56	58	48	67	55	54	46	17	21	20
Fixed Asset Turnover	7.0	6.8	7.3	10.8	6.9	6.2	6.3	10.0	9.4	8.1	7.5

Source: Company reports and Prudential Securities estimates.

Prudential Securities

Prudential Securities

Prudential Securities Incorporated makes a primary over-the-counter market in the shares of Amazon.com Inc.

Prudential Securities Incorporated acts as a specialist that makes a market in the security of Toys "R" Us. At any given time, the specialist may have a position, either long or short, in the security, and, as a result of the associated specialist's function as a market maker, such specialist may be on the opposite side of orders executed on the floor of a national securities exchange.

Any OTC-traded securities or non-U.S. companies mentioned in this report may not be cleared for sale in all states. See BLUE on ERA. **21-0153**

Additional information on the securities discussed herein is available upon request.