AMAZON COM INC
Form 10-Q
October 22, 2008
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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 September 30, 2008

or

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

Commission File No. 000-22513

Amazon.com, Inc.

(Exact Name of Registrant as Specified in its Charter)

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

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

(206) 266-1000

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

428,832,397 shares of common stock, par value $0.01 per share, outstanding as of October 16, 2008

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AMAZON.COM, INC.

FORM 10-Q

For the Quarterly Period Ended September 30, 2008

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		Twelve Months Ended September 30,	
	2008	2007	2008	2007	2008	2007
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 1,548	$ 1,004	$ 2,539	$ 1,022	$ 1,366	$ 693
OPERATING ACTIVITIES:						
Net income	118	80	420	269	627	367
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	76	61	210	183	273	242
Stock-based compensation	70	51	197	130	251	161
Other operating expense (income), net	7	3	(32)	6	(29)	8
Losses (gains) on sales of marketable securities, net	1		(2)	1	(2)	1
Other expense (income), net	(24)	3	(17)	12	(18)	12
Deferred income taxes	(17)	(2)	(47)	(1)	(144)	6
Excess tax benefits from stock-based compensation	(53)	(34)	(160)	(93)	(323)	(157)
Changes in operating assets and liabilities:						
Inventories	(243)	(223)	(130)	(72)	(361)	(199)
Accounts receivable, net and other	(9)	(73)	106	(17)	(131)	(134)
Accounts payable	362	304	(524)	(216)	620	372
Accrued expenses and other	101	58	39	29	437	276
Additions to unearned revenue	121	56	286	165	366	240
Amortization of previously unearned revenue	(86)	(47)	(220)	(139)	(291)	(194)
Net cash provided by operating activities	424	237	126	257	1,275	1,001
INVESTING ACTIVITIES:						
Purchases of fixed assets, including internal-use software and website development	(102)	(69)	(231)	(151)	(305)	(201)
Acquisitions, net of cash acquired, and other	(8)	(24)	(408)	(47)	(436)	(48)
Sales and maturities of marketable securities and other investments	582	210	1,033	1,156	1,149	2,025
Purchases of marketable securities and other investments	(478)	(83)	(1,229)	(777)	(1,382)	(2,118)
Net cash provided by (used in) investing activities	(6)	34	(835)	181	(974)	(342)
FINANCING ACTIVITIES:						
Proceeds from exercises of stock options	2	35	10	79	23	97
Excess tax benefits from stock-based compensation	53	34	160	93	323	157
Common stock repurchased				(248)		(248)
Proceeds from long-term debt and other		33	52	21	68	31
Repayments of long-term debt and capital lease obligations	(295)	(29)	(355)	(63)	(380)	(63)
Net cash provided by (used in) financing activities	(240)	73	(133)	(118)	34	(26)
Foreign-currency effect on cash and cash equivalents	(76)	18	(47)	24	(51)	40

Net increase (decrease) in cash and cash equivalents	102	362	(889)	344	284	673
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 1,650	$ 1,366	$ 1,650	$ 1,366	$ 1,650	$ 1,366
SUPPLEMENTAL CASH FLOW INFORMATION:						
Cash paid for interest	$ 14	$ 22	$ 61	$ 67	$ 62	$ 67
Cash paid for income taxes	5	4	28	14	38	15
Fixed assets acquired under capital leases and other financing arrangements	37	22	104	43	136	50
Fixed assets acquired under build-to-suit leases	19		35		50	
Conversion of debt	132	1	605	1	605	1

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Net sales	$ 4,264	$ 3,262	$ 12,463	$ 9,163
Cost of sales	3,265	2,500	9,541	6,980
Gross profit	999	762	2,922	2,183
Operating expenses (1):				
Fulfillment	393	296	1,109	815
Marketing	108	74	313	211
Technology and content	264	209	755	596
General and administrative	73	57	208	171
Other operating expense (income), net	7	3	(32)	6
Total operating expenses	845	639	2,353	1,799
Income from operations	154	123	569	384
Interest income	21	23	67	62
Interest expense	(17)	(19)	(60)	(57)
Other income (expense), net	24	(3)	22	(10)
Total non-operating income (expense)	28	1	29	(5)
Income before income taxes	182	124	598	379
Provision for income taxes	59	44	167	110
Equity-method investment activity, net of tax	5		11	
Net income	$ 118	$ 80	$ 420	$ 269
Basic earnings per share	$ 0.28	$ 0.19	$ 1.00	$ 0.65
Diluted earnings per share	$ 0.27	$ 0.19	$ 0.97	$ 0.64
Weighted average shares used in computation of earnings per share:				
Basic	427	414	421	412
Diluted	436	425	431	423
(1) Includes stock-based compensation as follows:				
Fulfillment	$ 15	$ 11	$ 42	$ 27
Marketing	4	2	10	6
Technology and content	38	28	109	72
General and administrative	13	10	36	25

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)

	September 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,650	$ 2,539
Marketable securities	674	573
Inventories	1,315	1,200
Accounts receivable, net and other	597	705
Deferred tax assets	194	147
Total current assets	4,430	5,164
Fixed assets, net	731	543
Deferred tax assets	278	260
Goodwill	405	222
Other assets	722	296
Total assets	$ 6,566	$ 6,485
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,242	$ 2,795
Accrued expenses and other	860	902
Current portion of long-term debt	42	17
Total current liabilities	3,144	3,714
Long-term debt	393	1,282
Other long-term liabilities	502	292
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 443 and 431		
Outstanding shares 429 and 416	4	4
Treasury stock, at cost	(500)	(500)
Additional paid-in capital	4,051	3,063
Accumulated other comprehensive income (loss)	(73)	5
Accumulated deficit	(955)	(1,375)
Total stockholders equity	2,527	1,197
Total liabilities and stockholders equity	$ 6,566	$ 6,485

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 2008 due to seasonal and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our 2007 Annual Report on Form 10-K. Certain prior period amounts have been reclassified to conform to the current period presentation.

Principles of Consolidation

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

Use of Estimates

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

Business Combinations

We acquired certain companies during the nine months ended September 30, 2008 for an aggregate purchase price of $329 million. The assets and liabilities of these acquisitions have been included in our consolidated financial statements at fair value, including acquired intangible assets of $138 million with estimated useful lives between two and ten years. The excess of purchase price over the fair value of the net assets acquired was $178 million and is classified as Goodwill on our consolidated balance sheets.

The purchase price allocation for each acquisition is preliminary and subject to revision, and any change to the fair value of net assets acquired will lead to a corresponding change to the purchase price allocable to goodwill. The results of operations of the acquired companies have been included in our consolidated results from each closing date forward. The effect of these acquisitions on consolidated net sales and operating income for Q3 2008 and the nine months ended September 30, 2008 was not significant.

Earnings per Share

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

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Our convertible debt instrument is excluded from the calculation of diluted earnings per share as its effect under the if-converted method is anti-dilutive. See Note 3 Long-Term Debt.

Treasury Stock

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

Internal-use Software and Website Development

Costs incurred to develop software for internal use are required to be capitalized and amortized over the estimated useful life of the software in accordance with Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.* Costs related to design or maintenance of internal-use software are expensed as incurred. During Q3 2008 and Q3 2007, we capitalized $41 million (including $7 million of stock-based compensation) and $35 million (including $6 million of stock-based compensation) of costs associated with internal-use software and website development. For the nine months ended September 30, 2008 and 2007, we capitalized $139 million (including $20 million of stock-based compensation) and $97 million (including $15 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $37 million and $30 million for Q3 2008 and Q3 2007, and $105 million and $85 million for the nine months ended September 30, 2008 and 2007.

Depreciation of Fixed Assets

Fixed assets include assets such as furniture and fixtures, heavy equipment, technology infrastructure, internal-use software and website development. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets (generally two years or less for assets such as internal-use software, two or three years for our technology infrastructure, five years for furniture and fixtures, and ten years for heavy equipment). Depreciation expense is generally classified within the corresponding operating expense categories on our consolidated statements of operations, and certain assets are amortized as Cost of sales. Depreciation expense for fixed assets was $80 million and $65 million for Q3 2008 and Q3 2007, and $225 million and $189 million for the nine months ended September 30, 2008 and 2007.

Other Assets

Included in Other assets on our consolidated balance sheets are amounts primarily related to marketable securities restricted for longer than one year, primarily attributable to collateralization of bank guarantees and debt related to our international operations; certain equity investments; intangible assets, net of amortization; and intellectual property rights, net of amortization. At September 30, 2008 and December 31, 2007, the cost basis which equaled the fair value of marketable securities restricted for longer than one year was $248 million and $197 million. At September 30, 2008 and December 31, 2007, equity investments were $247 million and $17 million, intangible assets, net, were $143 million and $26 million, and intellectual property rights, net were $44 million and $28 million.

Equity-method Investment Activity

Investments are accounted for using the equity method of accounting if the investment gives us the ability to exercise significant influence, but not control, over an investee. We classify our investments in equity-method investees on our consolidated balance sheets as Other assets and our share of the investees earnings or losses along with amortization of the related intangible assets, if any, as Equity-method investment activity, net of tax on our consolidated statements of operations.

We periodically evaluate whether declines in fair values of our equity-method investments below their book value are other-than-temporary. This evaluation consists of several qualitative and quantitative factors regarding the severity and duration of such declines. To the extent any impairment is considered other-than-temporary, the investment is written down to its fair value.

In Q2 2008, we sold our European DVD rental assets in exchange for a partial ownership in the acquiring company s business. Our investment was recorded based on the fair value of the assets received and is accounted for under the equity method of accounting. As a result of this transaction, we recorded a $53 million non-cash gain included in Other operating expense (income), net on our consolidated statements of operations.

Accrued Expenses and Other

Included in Accrued expenses and other at September 30, 2008 and December 31, 2007 were liabilities of $216 million and $230 million for unredeemed gift certificates. We recognize revenue from a gift certificate when a customer redeems it. If a gift certificate is not redeemed, we recognize revenue when it expires or, for a certificate without an expiration date, when the likelihood of its redemption becomes remote, generally two years from date of issuance.

Unearned Revenue

Unearned revenue is recorded when payments are received in advance of performing our service obligations and is recognized over the service period. Current unearned revenue is included in Accrued expenses and other and non-current unearned revenue is included in Other long-term liabilities on our consolidated balance sheets. Current unearned revenue was $158 million and $91 million at September 30, 2008 and December 31, 2007. Non-current unearned revenue was $41 million and $19 million at September 30, 2008 and December 31, 2007.

Income Taxes

Income tax expense includes U.S. and international income taxes. We do not provide for U.S. taxes on our undistributed earnings of foreign subsidiaries since we intend to invest such undistributed earnings indefinitely outside of the U.S. If such amounts were repatriated, determination of the amount of U.S. income taxes that would be incurred is not practicable due to the complexities associated with this calculation.

Under the Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes,* deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when taxes are actually paid or recovered.

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

Effective January 1, 2007, we adopted the provisions of the Financial Accounting Standards Board Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109.* FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies) accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate

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

Shipping Activities

Outbound shipping charges to customers are included in Net sales and were $191 million and $171 million for Q3 2008 and Q3 2007, and $569 million and $475 million for the nine months ended September 30, 2008 and 2007. Outbound shipping-related costs are included in Cost of sales and totaled $323 million and $260 million for Q3 2008 and Q3 2007, and $957 million and $725 million for the nine months ended September 30, 2008 and 2007. The net cost to us of shipping activities was $132 million and $89 million for Q3 2008 and Q3 2007, and $388 million and $250 million for the nine months ended September 30, 2008 and 2007.

Stock-Based Compensation

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

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. For financial assets and liabilities, SFAS No. 157 was effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. See Note 2 Cash, Cash Equivalents, and Marketable Securities for further discussion. In February 2008, the FASB issued Staff Position (FSP) No. 157-2 which delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-2 is effective for us beginning January 1, 2009.

Those assets and liabilities measured at fair value under SFAS No. 157 in Q1 2008 did not have a material impact on our consolidated financial statements. In accordance with FSP 157-2, we will measure the remaining assets and liabilities no later than Q1 2009, and are currently evaluating this impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements.* SFAS No. 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquired entity at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We are currently evaluating the impact of the pending adoption of SFAS No. 141 (R) and SFAS No. 160 on our consolidated financial statements.

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In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We are currently evaluating the impact of the pending adoption of FSP No. 142-3 on our consolidated financial statements.

In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-05, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock*. EITF Issue No. 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity s own stock, which would qualify as a scope exception under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. EITF Issue No. 07-05 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. We are currently evaluating the impact of the pending adoption of EITF Issue No. 07-05 on our consolidated financial statements.

Note 2 Cash, Cash Equivalents, and Marketable Securities

As of September 30, 2008 and December 31, 2007 our cash, cash equivalents, and marketable securities primarily consisted of cash, government and government agency securities, AAA-rated money market funds and other investment grade securities. Such amounts are recorded at fair value.

The following table summarizes, by major security type, our cash, cash equivalents, and marketable securities (in millions):

	September 30, 2008			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (1)	Total Estimated Fair Value
Cash	$ 414	$	$	$ 414
Money market funds	1,029			1,029
Foreign government and agency securities	568	1	(1)	568
Corporate debt securities (2)	206		(8)	198
U.S. government and agency securities	277	2		279
Asset-backed securities	62		(2)	60
Other fixed income securities	23			23
Equity securities	2		(1)	1
	$ 2,581	$ 3	$ (12)	$ 2,572
Less: Long-term marketable securities				(248)
Total cash, cash equivalents, and marketable securities				$ 2,324

(1) The cost and fair value of investments with loss positions was $523 million and $511 million. We evaluated the nature of these investments, credit worthiness of the issuer, and the duration of these impairments to determine if an other-than-temporary decline in fair value has occurred and concluded that these losses were temporary. Investments that have continuously been in loss positions for more than twelve months have gross unrealized losses of $4 million.

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

Effective January 1, 2008, we adopted SFAS No. 157, which clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value, and expands disclosures about fair value measurements. The three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies, is:

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

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

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

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

	September 30, 2008				
	Cash	Level 1 Estimated Fair Value	Level 2 Estimated Fair Value	Level 3 Estimated Fair Value	Total Estimated Fair Value
Cash	$ 414	$	$	$	$ 414
Money market funds		1,029			1,029
Foreign government and agency securities			568		568
Corporate debt securities			198		198
U.S. government and agency securities			279		279
Asset-backed securities			60		60
Other fixed income securities			23		23
Equity securities		1			1
	$ 414	$ 1,030	$ 1,128	$	$ 2,572

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. See Note 4 Commitments and Contingencies.

Note 3 Long-Term Debt

Our long-term debt is summarized as follows:

	September 30, 2008	December 31, 2007
	(in millions)	
6.875% PEACS due February 2010 (1)	$ 338	$ 350
4.75% Convertible Subordinated Notes		899
Other long-term debt	97	50
	435	1,299
Less current portion of long-term debt	(42)	(17)
	$ 393	$ 1,282
Fair value of long-term debt (2)	$ 431	$ 1,466

(1) The 6.875% Premium Adjustable Convertible Securities (6.875% PEACS) are convertible into our common stock at the holders option at a conversion price of 84.883 per share ($119.62 per share, based on the exchange rate as of September 30, 2008). Total common stock issuable upon conversion of our outstanding 6.875% PEACS is 2.8 million shares, which is excluded from our calculation of earnings per share as its effect is currently anti-dilutive. The U.S. Dollar equivalent principal, interest, and conversion price fluctuate based on the Euro/U.S. Dollar exchange ratio. We have the right to redeem the 6.875% PEACS, in whole or in part, by paying the principal plus any accrued and unpaid interest.

(2) The fair value of our 6.875% PEACS was $334 million and $358 million at September 30, 2008 and December 31, 2007. The fair value of our 4.75% Convertible Subordinated Notes was $1.1 billion at December 31, 2007. Such amounts are determined based on quoted prices in active markets for similar instruments (Level 2 as defined under SFAS No. 157).

In February 2008 our Board of Directors authorized a debt repurchase program, replacing our previous debt repurchase authorization in its entirety, pursuant to which we could from time to time repurchase (through open market repurchases or private transactions), redeem, or otherwise retire up to an aggregate of all of our outstanding 4.75% Convertible Subordinated Notes and 6.875% PEACS.

In Q3 2008 and Q2 2008, we called for redemption principal amounts of $399 million and $500 million of our outstanding 4.75% Convertible Subordinated Notes. For our Q3 2008 redemption, holders elected to convert $132 million in principal amount of the 4.75% Convertible Subordinated Notes, and we issued 1.7 million shares of our common stock as a result; we redeemed the remaining $266 million of the called principal amount for cash. For our Q2 2008 redemption, holders elected to convert $473 million in principal amount of the 4.75% Convertible Subordinated Notes, and we issued 6.1 million shares of our common stock as a result; we redeemed the remaining $27 million of the called principal amount for cash.

Note 4 Commitments and Contingencies

Commitments

We enter into leases for office and fulfillment center facilities and fixed assets under non-cancelable operating and capital leases and build-to-suit arrangements. Rental expense under operating lease agreements was $38 million and $35 million for Q3 2008 and Q3 2007, and $117 million and $102 million for the nine months ended September 30, 2008 and 2007.

In December 2007, we entered into a series of leases and other agreements for the lease of corporate office space to be developed in Seattle, Washington with initial terms of up to 16 years commencing on completion of development in 2010 and 2011, and options to extend for two five year periods. Under the agreements we committed to occupy approximately 820,000 square feet of office space. During the nine months ended September 30, 2008, we committed to occupy an additional approximately 540,000 square feet. In Q3 2008, we made an election to occupy up to an additional approximately 330,000 square feet, subject to a termination fee, estimated to be up to approximately $10 million, if we elect not to occupy the additional space. We also have options to lease up to an additional approximately 500,000 square feet at rates based on fair market values at the time the options are exercised, subject to certain conditions. If interest rates exceed a certain threshold, we have the option to provide financing for some of the buildings.

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The following summarizes our principal contractual commitments, excluding open orders for inventory purchases that support normal operations, as of September 30, 2008:

	Three Months Ended December 31, 2008	Year Ended December 31, 2009	2010	2011	2012	Thereafter	Total
				(in millions)			
Operating and capital commitments:							
Debt principal (1)	$ 7	$ 35	$ 338	$ 22	$ 33	$	$ 435
Debt interest (1)	2	29	28	3	1		63
Capital leases, including interest	19	66	60	27	6	5	183
Operating leases	42	132	113	88	76	301	752
Other commitments (2)(3)	22	44	96	131	81	1,120	1,494
Total commitments	$ 92	$ 306	$ 635	$ 271	$ 197	$ 1,426	$ 2,927

(1) Under our 6.875% PEACS, the principal payment due in 2010 and the annual interest payments fluctuate based on the Euro/U.S. Dollar exchange ratio. At September 30, 2008, the Euro to U.S. Dollar exchange rate was 1.4092. Due to changes in the Euro/U.S. Dollar exchange ratio, our remaining principal debt obligation under this instrument since issuance in February 2000 has increased by $102 million as of September 30, 2008. The principal and interest commitments reflect the partial redemption of the 6.875% PEACS and full redemption of the 4.75% Convertible Subordinated Notes.

(2) Includes the estimated timing and amounts of payments for rent, operating expenses, and tenant improvements associated with approximately 1,360,000 square feet of corporate office space being developed in Seattle, Washington with initial terms of up to 16 years commencing on completion of development in 2010 and 2011, and also includes the $10 million termination fee related to our election to occupy an additional approximately 330,000 square feet. The amount of space available and our financial and other obligations under the lease agreements are affected by various factors, including government approvals and permits, interest rates, development costs and other expenses and our exercise of certain rights under the lease agreements.

(3) Includes commitments to acquire intellectual property and tax contingencies under FIN 48, but excludes $114 million of such tax contingencies for which we cannot make a reasonably reliable estimate of the amount and period of payment. See Note 1 Accounting Policies Income Taxes.

Additionally, we entered into an agreement in Q3 2008, subject to regulatory conditions and other approvals, to acquire a company, and closed an acquisition for an additional company in October 2008. These acquisitions result in aggregate commitments of approximately $110 million.

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Pledged Securities

We are required to pledge or otherwise restrict a portion of our cash and marketable securities as collateral for standby letters of credit, guarantees, debt, and real estate leases. We classify cash and marketable securities with use restrictions of twelve months or longer as non-current Other assets on our consolidated balance sheets. The balance of pledged securities at September 30, 2008 consisted of $38 million in Cash and cash equivalents and Marketable securities, and $248 million in Other assets. The amount required to be pledged for certain real estate lease agreements changes over the life of our leases based on our credit rating and changes in our market capitalization (common shares outstanding multiplied by the closing price of our common stock). Information about collateral required to be pledged under these agreements is as follows:

	Standby and Trade Letters of Credit and Guarantees	Debt (1)	Real Estate Leases (2)	Total
		(in millions)		
Balance at December 31, 2007	$ 138	$ 60	$ 13	$ 211
Net change in collateral pledged	20	57	(2)	75
Balance at September 30, 2008	$ 158	$ 117	$ 11	$ 286

(1) Represents collateral for certain debt related to our international operations.
(2) At September 30, 2008, our market capitalization was $31.2 billion. The required amount of collateral to be pledged will increase by $5 million if our market capitalization is equal to or below $18 billion and by an additional $6 million if our market capitalization is equal to or below $13 billion.

Legal Proceedings

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

In June 2001, Audible, Inc., our subsidiary acquired in March 2008, was named as a defendant in a securities class-action filed in United States District Court for the Southern District of New York related to its initial public offering in July 1999. The lawsuit also named certain of the offering s underwriters, as well as Audible s officers and directors as defendants. Approximately 300 other issuers and their underwriters have had similar suits filed against them, all of which are included in a single coordinated proceeding in the Southern District of New York. The complaints allege that the prospectus and the registration statement for Audible s offering failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some investors allegedly agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of the Company s stock. Audible and its officers and directors were named in the suits pursuant to Section 11 of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and other related provisions. The complaints seek unspecified damages, attorney and expert fees, and other unspecified litigation costs. The Court has directed that the litigation proceed with a number of focus cases rather than all of the consolidated cases at once. Audible s case is not one of these focus cases. We dispute the allegations of wrongdoing in the complaint against Audible and its officers and directors and intend to vigorously defend ourselves in this matter.

Beginning in March 2003, we were served with complaints filed in several different states, including Illinois, by a private litigant, Beeler, Schad & Diamond, P.C., purportedly on behalf of the state governments under various state False Claims Acts. The complaints allege that we (along with other companies with which we have commercial agreements) wrongfully failed to collect and remit sales and use taxes for sales of personal property to customers in those states and knowingly created records and statements falsely stating we were not required to collect or remit such taxes. In December 2006, we learned that one additional complaint was filed in the state of Illinois by a different private litigant, Matthew T. Hurst, alleging similar violations of the Illinois state law. All of the complaints seek injunctive relief, unpaid taxes, interest, attorneys fees, civil penalties of up

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to $10,000 per violation, and treble or punitive damages under the various state False Claims Acts. It is possible that we have been or will be named in similar cases in other states as well. We dispute the allegations of wrongdoing in these complaints and intend to vigorously defend ourselves in these matters.

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

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

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

In April 2007, SBJ Holdings 1, LLC filed a complaint against us in the United States District Court for the Eastern District of Texas. The complaint alleges that our website technology infringes a patent obtained by SBJ Holdings 1 purporting to cover a Method, Memory, Product, and Code for Displaying Pre-Customized Content Associated with Visitor Data (U.S. Patent No. 6,330,592) and seeks injunctive relief, monetary damages, treble damages for alleged willful infringement, prejudgment and post-judgment interest, costs and attorneys fees. In September 2008, we entered into a settlement of the litigation that included, among other things, a non-exclusive license to the patent in suit.

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

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

See also Note 8 Income Taxes.

Note 5 Stockholders Equity

Stock Conversion Activity

In Q3 2008 and Q2 2008, holders of our 4.75% Convertible Subordinated Notes elected to convert a total of $132 million and $473 million in outstanding principal amount under called redemptions, and we issued 1.7 million and 6.1 million shares of common stock as a result of such elections.

Stock Repurchase Activity

We repurchased 6.3 million shares for $248 million in Q1 2007 under a 24-month program authorized by our Board of Directors in August 2006. In April 2007, our Board authorized a new 24-month program to repurchase up to $500 million of our common stock, which was replaced in February 2008 by a 24-month program to repurchase up to $1 billion of our common stock.

Stock Award Activity

We granted restricted stock units representing 0.9 million and 0.4 million shares of common stock during Q3 2008 and Q3 2007 with a per share weighted average fair value of $76.59 and $84.06. For the nine months ended September 30, 2008 and 2007, we granted restricted stock units representing 6.4 million and 7.3 million shares of common stock with a per share weighted average fair value of $75.06 and $45.85. Our annual stock awards are granted in the second quarter.

Common shares underlying outstanding stock awards were as follows:

	September 30, 2008	December 31, 2007
	(in millions)	
Restricted stock units	17.9	16.3
Stock options (1)	1.3	1.9
Total outstanding stock awards	19.2	18.2

(1) The weighted average per share exercise price was $25.06 and $17.46 at September 30, 2008 and December 31, 2007.

Common shares outstanding (which includes restricted stock), plus shares underlying outstanding stock options and restricted stock units totaled 448 million and 435 million at September 30, 2008 and December 31, 2007. These totals include all stock-based awards outstanding, without regard for estimated forfeitures, consisting of vested and unvested awards, and in-the-money and out-of-the-money stock options.

The following table summarizes our restricted stock unit activity for the nine months ended September 30, 2008 (in millions):

	Number of Units
Outstanding at December 31, 2007	16.3
Units granted	6.4
Units vested	(3.6)
Units cancelled	(1.2)
Outstanding at September 30, 2008	17.9

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Scheduled vesting for outstanding restricted stock units at September 30, 2008 is as follows (in millions):

	Three Months Ended December 31, 2008	Year Ended December 31, 2009	2010	2011	2012	Thereafter	Total
Scheduled vesting restricted stock units	1.9	6.1	5.1	2.6	1.3	0.9	17.9

As of September 30, 2008, there was $378 million of net unrecognized compensation cost related to unvested stock-based compensation arrangements. This compensation is recognized on an accelerated basis resulting in approximately half of the compensation expected to be expensed in the next twelve months and has a weighted average recognition period of 1.3 years.

Note 6 Comprehensive Income

Comprehensive income was $40 million and $87 million for Q3 2008 and Q3 2007, and $342 million and $280 million for the nine months ended September 30, 2008 and 2007. The primary differences between net income as reported and comprehensive income are foreign currency translation adjustments, net of tax, and changes in unrealized gains and losses on available-for-sale securities, net of tax.

Note 7 Other Income (Expense), Net

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)		(in millions)	
Foreign-currency gain (loss) on remeasurement of 6.875% PEACS	$ 40	$ (17)	$ 12	$ (25)
Foreign-currency gain (loss) on intercompany balances	(16)	16	9	22
Other		(2)	1	(7)
Total other income (expense), net	$ 24	$ (3)	$ 22	$ (10)

Note 8 Income Taxes

Our tax provision for interim periods is determined using an estimate of our annual effective tax rate adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter we update our estimate of the annual effective tax rate, and if our estimated tax rate changes we make a cumulative adjustment. The 2008 annual effective tax rate is estimated to be lower than the 35% U.S. federal statutory rate primarily due to anticipated earnings of our subsidiaries outside of the U.S. in jurisdictions where our effective tax rate is lower than in the U.S. Included in the total tax provision as a discrete item recognized in Q2 2008 is the impact related to the $53 million non-cash gain associated with the sale of our European DVD rental assets. This gain will be taxed at rates substantially below the 35% U.S. federal statutory rate. Cash paid for income taxes was $5 million and $4 million in Q3 2008 and Q3 2007, and $28 million and $14 million for the nine months ended September 30, 2008 and 2007.

As of September 30, 2008 and December 31, 2007, tax contingencies were $120 million and $112 million. Changes to these tax contingencies that are reasonably possible in the next 12 months are not significant.

We are under examination, or may be subject to examination, by the Internal Revenue Service (IRS) for calendar years 2004 through 2007. Additionally, any net operating losses that were generated in prior years and utilized in these years 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 2003 through 2007, France for 2005 through 2007, Germany for 2003 through 2007, Luxembourg for 2003 through 2007, and the United Kingdom for 2003 through 2007. In addition, in 2007, Japanese tax authorities assessed income tax, including penalties and interest, of approximately $101 million against one of our U.S. subsidiaries for the years 2003 through 2005. We believe that these claims are without merit and are disputing the assessment. Further proceedings on the assessment will be stayed during negotiations between U.S. and Japanese authorities over the double taxation issues the assessment raises, and we have provided bank guarantees to suspend enforcement of the assessment. We also may be subject to income tax examination by Japanese tax authorities for 2006 and 2007.

Note 9 Segment Information

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)		(in millions)	
North America				
Net sales	$ 2,302	$ 1,788	$ 6,597	$ 5,012
Cost of sales	1,716	1,328	4,883	3,679
Gross profit	586	460	1,714	1,333
Direct segment operating expenses	498	381	1,400	1,087
Segment operating income	$ 88	$ 79	$ 314	$ 246
International				
Net sales	$ 1,962	$ 1,474	$ 5,866	$ 4,151
Cost of sales	1,549	1,172	4,658	3,301
Gross profit	413	302	1,208	850
Direct segment operating expenses	270	204	788	576
Segment operating income	$ 143	$ 98	$ 420	$ 274
Consolidated				
Net sales	$ 4,264	$ 3,262	$ 12,463	$ 9,163
Cost of sales	3,265	2,500	9,541	6,980
Gross profit	999	762	2,922	2,183
Direct segment operating expenses	768	585	2,188	1,663
Segment operating income	231	177	734	520
Stock-based compensation	(70)	(51)	(197)	(130)
Other operating income (expense), net	(7)	(3)	32	(6)
Income from operations	154	123	569	384
Total non-operating expense, net	28	1	29	(5)
Provision for income taxes	(59)	(44)	(167)	(110)
Equity-method investment activity, net of tax	(5)		(11)	
Net income	$ 118	$ 80	$ 420	$ 269

Note 10 Subsequent Event

In October 2008, a third party announced the acquisition of a company in which we held an equity-method investment. Subject to the closing of the acquisition, which is expected to occur in Q4 2008, we will receive approximately $150 million in cash for our equity ownership.

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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 recent disruptions in the global financial markets amplify 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.

Overview

Our primary source of revenue is the sale of a wide range of products and services to customers. The products offered on our customer-facing websites primarily include merchandise and content we have purchased for resale from vendors and products offered by marketplace sellers. Generally, we recognize gross revenue from items we sell from our inventory and recognize our net share of revenue of items sold by other sellers. We also offer services such as Amazon Web Services, Amazon Enterprise Solutions, co-branded credit cards, fulfillment, and miscellaneous marketing and promotional offers.

Our financial focus is on long-term, sustainable growth in free cash flow[1] *per share.* Free cash flow is driven primarily by increasing operating income and efficiently managing working capital and capital expenditures. Increases in operating income primarily result from increases in sales through our websites and efficiently managing our operating costs, offset by investments we make in longer-term strategic initiatives, which generally require us to hire additional software engineers, computer scientists, and merchandisers. To increase product sales, we focus on improving all aspects of the customer experience, including lowering prices, improving availability, offering faster delivery times, increasing selection, increasing product categories, expanding product information, improving ease of use, and earning customer trust. We generally focus on growing gross profit and operating profit dollars rather than maximizing margin percentages.

We also seek to efficiently manage shareholder dilution while maintaining the flexibility to issue shares for strategic purposes, such as financings and aligning employee compensation with shareholders interests. We utilize restricted stock units as our primary vehicle for equity compensation because we believe they align the interests of our shareholders and employees. In managing shareholder dilution, we include all stock awards outstanding, without regard to estimated forfeitures, consisting of vested and unvested awards and in-the-money

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

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and out-of-the-money stock options. Total shares outstanding plus outstanding stock awards were 448 million and 435 million at September 30, 2008 and December 31, 2007. These amounts exclude 2.8 million and 14 million shares issuable upon conversion of our long-term debt at September 30, 2008 and December 31, 2007.

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

Because of our model we are able to turn our inventory quickly and have a cash-generating operating cycle[2]. On average, our high inventory velocity means we generally collect from our customers before our payments to suppliers come due. Inventory turnover[3] was 12 for both Q3 2008 and Q3 2007. We expect some variability in inventory turnover over time since 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. Accounts payable days[4] were 63 and 62 for Q3 2008 and Q3 2007. We expect some variability in accounts payable days over time since they are affected by several factors, including the mix of product sales, the mix of sales by other sellers, the mix of suppliers, seasonality, and changes in payment terms over time, including the effect of balancing pricing and timing of payment terms with suppliers.

We expect spending in technology and content will increase over time as we add computer scientists, software engineers, and employees involved in category expansion, editorial content, buying, merchandising selection, and systems support. We seek to efficiently invest in several areas of technology and content, including seller platforms, web services, digital initiatives, and expansion of new and existing product categories, as well as in technology infrastructure to enhance the customer experience, improve our process efficiencies and support our infrastructure web services. We believe that advances in technology, specifically the speed and reduced cost of processing power, the improved consumer experience of the Internet outside of the workplace through lower-cost broadband service to the home, and the advances of wireless connectivity, will continue to improve the consumer experience on the Internet and increase its ubiquity in people s lives. We are investing in Amazon Web Services, which provides technology services that give developers access to technology infrastructure that they can use to enable virtually any type of business. A continuing challenge will be to continue to build and deploy innovative and efficient software that will best take advantage of continued advances in technology.

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

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

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

[4] Accounts payable days, calculated as the quotient of accounts payable to cost of sales, multiplied by the number of days in the period.

economy through our growing international businesses benefits our shareholders over the long term. We also believe it is important to evaluate our operating results and growth rates before and after the effect of currency changes.

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

Critical Accounting Judgments

The preparation of financial statements in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The SEC has defined a company s critical accounting policies as the ones that are most important to the portrayal of the company s financial condition and results of operations, and which require 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 2007 Annual Report on Form 10-K. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions.

Revenue Recognition

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

We evaluate the criteria of EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as commissions. Generally, when we are the primary party obligated in a transaction, are subject to inventory risk, have latitude in establishing prices and selecting suppliers, or have several but not all of these indicators, revenue is recorded gross. If we are not primarily obligated and amounts earned are determined using a percentage, a fixed-payment schedule, or a combination of the two, we generally record the net amounts as commissions earned.

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

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

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

Inventories

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

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

Investments

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

Goodwill and Long-Lived Assets

Goodwill is tested for impairment annually and when an event occurs or circumstances change such that it is reasonably possible that an impairment may exist. Our annual testing date is October 1. We test goodwill for impairment by first comparing the book value of net assets to the fair value of the related operations. If the fair value is determined to be less than book value, a second step is performed to compute the amount of impairment. In this process, a fair value for goodwill is estimated, based in part on the fair value of the operations, and is compared to its carrying value. The shortfall of the fair value below carrying value represents the amount of goodwill impairment.

Internal-Use Software and Website Development

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

Currency Effect on Intercompany Balances

Gains and losses arising from intercompany foreign currency transactions are included in net income.

Stock-Based Compensation

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

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

Income Taxes

We are subject to income taxes in both the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves for tax contingencies are established when we believe that certain positions might be challenged despite our belief that our tax return positions are fully supportable. We adjust these reserves in light of changing facts and circumstances, such as the outcome of tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate.

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when taxes are actually paid or recovered. The majority of our gross deferred tax assets relate to net operating loss carryforwards attributable to differences in stock-based compensation between the financial statements and our tax returns.

SFAS No. 109, *Accounting for Income Taxes,* requires that deferred tax assets be evaluated for future realization and reduced by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience and expectations of future taxable income by taxing jurisdiction, the

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

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

Effective January 1, 2007, we adopted the provisions of FIN No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109.* FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. For financial assets and liabilities, SFAS No. 157 was effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. See Financial Statements Note 2 Cash, Cash Equivalents, and Marketable Securities for further discussion. In February 2008, the FASB issued FSP No. 157-2 which delays the effective date of SFAS No. 157 one year for all nonfinancial assets and nonfinancial liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-2 is effective for us beginning January 1, 2009.

Those assets and liabilities measured at fair value under SFAS No. 157 in Q1 2008 did not have a material impact on our consolidated financial statements. In accordance with FSP 157-2, we will measure the remaining assets and liabilities no later than Q1 2009, and are currently evaluating this impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (R), *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements.* SFAS No. 141 (R) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquired entity at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. SFAS No. 141 (R) and SFAS No. 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We are currently evaluating the impact of the pending adoption of SFAS No. 141 (R) and SFAS No. 160 on our consolidated financial statements.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We are currently evaluating the impact of the pending adoption of FSP No. 142-3 on our consolidated financial statements.

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In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-05, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock*. EITF Issue No. 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity s own stock, which would qualify as a scope exception under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. EITF Issue No. 07-05 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. We are currently evaluating the impact of the pending adoption of EITF Issue No. 07-05 on our consolidated financial statements.

Liquidity and Capital Resources

Cash flow information is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,		Twelve Months Ended September 30,	
	2008	2007	2008	2007	2008	2007
	(in millions)		(in millions)		(in millions)	
Operating activities	$ 424	$ 237	$ 126	$ 257	$ 1,275	$ 1,001
Investing activities	(6)	34	(835)	181	(974)	(342)
Financing activities	(240)	73	(133)	(118)	34	(26)

Our financial focus is on long-term, sustainable growth in free cash flow. Free cash flow, a non-GAAP financial measure, was $970 million for the trailing twelve months ended September 30, 2008, compared to $800 million for the trailing twelve months ended September 30, 2007, an increase of 21%. See Item 2 of Part I, Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Non-GAAP Financial Measures for a reconciliation of free cash flow to net cash provided by operating activities. Operating cash flows and free cash flows can be volatile and are sensitive to many factors, including changes in working capital and the timing and magnitude of capital expenditures. Working capital at any specific point in time is subject to many variables, including seasonality, inventory management and category expansion, the timing of cash receipts and payments, vendor payment terms, valuation of cash equivalents and marketable securities, and fluctuations in foreign exchange rates.

Our principal sources of liquidity are cash flows generated from operations and our cash, cash equivalents, and marketable securities balances, which, at fair value, were $2.3 billion and $3.1 billion at September 30, 2008 and December 31, 2007. Amounts held in foreign currencies were $1.2 billion at both September 30, 2008 and December 31, 2007, and were primarily Euros, British Pounds, and Japanese Yen. See Item 1 of Part I, Financial Statements Note 1 Accounting Policies Income Taxes.

Cash provided by operating activities was $424 million and $237 million for Q3 2008 and Q3 2007. Cash provided by operating activities was $126 million and $257 million for the nine months ended September 30, 2008 and 2007. Our operating cash flows result primarily from cash received from our customers, from sellers, and from non-retail activities such as through our co-branded credit card agreements, Amazon Enterprise Solutions, and miscellaneous marketing and promotional agreements, offset by cash payments we make for products and services, employee compensation (less amounts capitalized pursuant to SOP 98-1 that are reflected as cash used in investing activities), payment processing and related transaction costs, operating leases, and interest payments on our long-term debt obligations. Cash received from customers, sellers, developers, and other activities generally corresponds to our net sales. Because our customers primarily use credit cards to buy from us, our receivables from customers settle quickly.

Cash provided by (used in) investing activities corresponds with purchases, sales, and maturities of marketable securities, cash outlays for acquisitions, equity-method investments and intellectual property rights, and purchases of fixed assets, including internal-use software and website development costs. Cash provided by (used in) investing activities was $(6) million and $34 million for Q3 2008 and Q3 2007. Cash provided by (used

in) investing activities was $(835) million and $181 million for the nine months ended September 30, 2008 and 2007. Capital expenditures were $102 million and $69 million during Q3 2008 and Q3 2007, and $231 million and $151 million for the nine months ended September 30, 2008 and 2007, with these increases primarily reflecting additional investments in technology infrastructure, fulfillment-related assets and the development of new features and product offerings on our websites. Capital expenditures included $34 million and $28 million for internal-use software and website development during Q3 2008 and Q3 2007, and $96 million and $81 million for the nine months ended September 30, 2008 and 2007. Stock-based compensation capitalized for internal-use software and website development costs does not affect cash flows. During the nine months ended September 30, 2008 and 2007, we made cash payments, net of acquired cash, related to acquisition and investment activity of $408 million and $47 million.

Cash provided by (used in) financing activities was $(240) million and $73 million for Q3 2008 and Q3 2007. Cash used in financing activities was $133 million and $118 million for the nine months ended September 30, 2008 and 2007. Cash outflows from financing activities result from repurchases of common stock, repayments of long-term debt, and payments on capital lease obligations. In Q1 2007, we repurchased $248 million of our common stock under the $500 million repurchase program authorized by our Board of Directors in August 2006. Repayments on long-term debt and payments on capital lease obligations were $295 million and $29 million in Q3 2008 and Q3 2007, and $355 million and $63 million for the nine months ended September 30, 2008 and 2007. Cash inflows from financing activities primarily result from proceeds from tax benefits relating to excess stock-based compensation deductions and exercises of employee stock options. SFAS No. 123(R) requires the reporting of tax benefits relating to excess stock-based compensation deductions in financing cash flows. Cash inflows from tax benefits related to stock-based compensation deductions were $53 million and $34 million for Q3 2008 and Q3 2007, and $160 million and $93 million for the nine months ended September 30, 2008 and 2007. Cash inflows from proceeds from exercise of employee stock options were $2 million and $35 million for Q3 2008 and Q3 2007, and $10 million and $79 million for the nine months ended September 30, 2008 and 2007. We expect cash proceeds from exercises of stock options will decline over time as we continue issuing restricted stock units as our primary vehicle for stock-based awards.

We recorded net tax provisions of $59 million and $44 million in Q3 2008 and Q3 2007, and $167 million and $110 million for the nine months ended September 30, 2008 and 2007. A majority of this provision is non-cash. We have current tax benefits and net operating losses relating to excess stock-based compensation deductions that are being utilized to reduce our U.S. taxable income. As such, cash taxes paid were $5 million and $4 million for Q3 2008 and Q3 2007, and $28 million and $14 million for the nine months ended September 30, 2008 and 2007. We endeavor to optimize our global taxes on a cash basis, rather than on a financial reporting basis.

In February 2008, our Board of Directors authorized a debt repurchase program, replacing our previous debt repurchase authorization in its entirety, pursuant to which we may from time to time repurchase (through open market repurchases or private transactions), redeem, or otherwise retire up to all of our outstanding 4.75% Convertible Subordinated Notes due 2009 and 6.875% PEACS.

In Q3 2008 and Q2 2008, we called for redemption principal amounts of $399 million and $500 million of our outstanding 4.75% Convertible Subordinated Notes. For our Q3 2008 redemption, holders elected to convert $132 million in principal amount of the 4.75% Convertible Subordinated Notes, and we issued 1.7 million shares of our common stock as a result; we redeemed the remaining $266 million of the called principal amount for cash. For our Q2 2008 redemption, holders elected to convert $473 million in principal amount of the 4.75% Convertible Subordinated Notes, and we issued 6.1 million shares of our common stock as a result; we redeemed the remaining $27 million for the called principal amount for cash. At September 30, 2008, the debt balance of our 4.75% Convertible Subordinated Notes was zero, and the debt balance of our 6.875% PEACS was $338 million.

In August 2006, our Board of Directors authorized a 24-month program to repurchase up to $500 million of our common stock, pursuant to which we repurchased $252 million and $248 million of our common stock in

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2006 and 2007, respectively. In April 2007, our Board authorized a new 24-month program to repurchase up to $500 million of our common stock, which was replaced in February 2008 by a 24-month program to repurchase up to $1 billion of our common stock.

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

On average, our high inventory velocity means we collect from our customers before our payments to suppliers come due. Inventory turnover was 12 for both Q3 2008 and Q3 2007. 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.

The following summarizes our principal contractual commitments as of September 30, 2008:

	Three Months Ended December 31,	Year Ended December 31,					
	2008	2009	2010	2011	2012	Thereafter	Total
	(in millions)						
Operating and capital commitments:							
Debt principal (1)	$ 7	$ 35	$ 338	$ 22	$ 33	$	$ 435
Debt interest (1)	2	29	28	3	1		63
Capital leases, including interest	19	66	60	27	6	5	183
Operating leases	42	132	113	88	76	301	752
Other commitments (2)(3)	22	44	96	131	81	1,120	1,494
Purchase obligations and open purchase orders (4)	1,825						1,825
Total commitments	$ 1,917	$ 306	$ 635	$ 271	$ 197	$ 1,426	$ 4,752

(1) At September 30, 2008, the Euro to U.S. Dollar exchange rate was 1.4092. Due to changes in the Euro/U.S. Dollar exchange ratio, our remaining principal debt obligation under the 6.875% PEACS since issuance in February 2000 has increased by $102 million as of September 30, 2008. The principal and interest commitments reflect the partial redemption of the 6.875% PEACS and full redemption of the 4.75% Convertible Subordinated Notes.

(2) Includes the estimated timing and amounts of payments for rent, operating expenses, and tenant improvements associated with approximately 1,360,000 square feet of corporate office space being developed in Seattle, Washington with initial terms of up to 16 years commencing on completion of development in 2010 and 2011, and also includes the $10 million termination fee related to our election to occupy an additional approximately 330,000 square feet. The amount of space available and our financial and other obligations under the lease agreements are affected by various factors, including government approvals and permits, interest rates, development costs and other expenses and our exercise of certain rights under the lease agreements. See Item 1 of Part I, Financial Statements Note 4 Commitments and Contingencies.

(3) Includes commitments to acquire intellectual property and tax contingencies under FIN 48, but excludes $114 million of such tax contingencies for which we cannot make a reasonably reliable estimate of the amount and period of payment. See Item 1 of Part I, Financial Statements Note 1 Accounting Policies Income Taxes.

(4) Consists of inventory and significant non-inventory commitments.

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Additionally, we entered into an agreement in Q3 2008, subject to regulatory conditions and other approvals, to acquire a company, and closed an acquisition for an additional company in October 2008. These acquisitions result in aggregate amount of approximately $110 million.

Pledged Securities

We are required to pledge or otherwise restrict a portion of our cash and marketable securities as collateral for standby letters of credit, guarantees, debt, and real estate leases. We classify cash and marketable securities with use restrictions of twelve months or longer as non-current "Other assets" on our consolidated balance sheets. The balance of pledged securities at September 30, 2008 consisted of $38 million in "Cash and cash equivalents" and "Marketable securities," and $248 million in "Other assets." The amount required to be pledged for certain real estate lease agreements changes over the life of our leases based on our credit rating and changes in our market capitalization (common shares outstanding multiplied by the closing price of our common stock). Information about collateral required to be pledged under these agreements is as follows:

	Standby and Trade Letters of Credit and Guarantees	Debt (1)	Real Estate Leases (2)	Total
		(in millions)		
Balance at December 31, 2007	$ 138	$ 60	$ 13	$ 211
Net change in collateral pledged	20	57	(2)	75
Balance at September 30, 2008	$ 158	$ 117	$ 11	$ 286

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

(2) At September 30, 2008, our market capitalization was $31.2 billion. The required amount of collateral to be pledged will increase by $5 million if our market capitalization is equal to or below $18 billion and by an additional $6 million if our market capitalization is equal to or below $13 billion.

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 long-term debt for strategic reasons or to further strengthen our financial position. The sale of additional equity or convertible debt securities would likely be dilutive to our shareholders. In addition, we will, from time to time, consider the acquisition of, or investment in, complementary businesses, products, services, and technologies, which might affect our liquidity requirements or cause us to issue additional equity or debt securities. There can be no assurance that additional lines-of-credit or financing instruments will be available in amounts or on terms acceptable to us, if at all.

Results of Operations

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

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Net Sales and Gross Profit

Net sales information is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)		(in millions)	
Net Sales:				
North America	$ 2,302	$ 1,788	$ 6,597	$ 5,012
International	1,962	1,474	5,866	4,151
Consolidated	$ 4,264	$ 3,262	$ 12,463	$ 9,163
Year-over-year Percentage Growth:				
North America	29%	42%	32%	37%
International	33	40	41	35
Consolidated	31	41	36	36
Year-over-year Percentage Growth, excluding effect of exchange rates:				
North America	29%	42%	31%	37%
International	28	33	31	29
Consolidated	28	38	31	33
Net Sales Mix:				
North America	54%	55%	53%	55%
International	46	45	47	45
Consolidated	100%	100%	100%	100%

Revenue increased 31% in Q3 2008 and 36% for the nine months ended September 30, 2008, reflecting revenue growth in both our North America and International segments. We experienced slower rates of growth towards the end of the third quarter, coinciding with disruptions in the global financial markets. Additionally, changes in currency exchange rates positively affected net sales by $80 million in Q3 2008 and $447 million for the nine months ended September 30, 2008. For a discussion of the effect on revenue growth of exchange rates, see Effect of Exchange Rates below. The Q3 2007 and nine months ended September 30, 2007 growth rates include the effects of the release of *Harry Potter and the Deathly Hallows*. We sold 2.5 million copies during Q3 2007.

The North America revenue growth rate was 29% for Q3 2008 and 32% for the nine months ended September 30, 2008. This revenue growth primarily reflects increased unit sales driven largely by our continued efforts to reduce prices for our customers, including from our free shipping offers and Amazon Prime, and by increased in-stock inventory availability and increased selection of product offerings, as well as a larger base of sales in faster growing categories such as electronics and other general merchandise.

The International revenue growth rate was 33% for Q3 2008 and 41% for the nine months ended September 30, 2008. This revenue growth primarily reflects increased unit sales driven largely by our continued efforts to reduce prices for our customers, including from our free shipping offers, and by increased in-stock inventory availability and increased selection of product offerings, as well as a larger base of sales in faster growing categories such as electronics and other general merchandise. Additionally, changes in currency exchange rates positively affected International net sales by $80 million for Q3 2008 and $439 million for the nine months ended September 30, 2008.

We expect that, over time, our International segment will represent more than 50% of our consolidated net sales. Additionally, as we continue to offer increased selection, lower prices, and additional product lines within

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our electronics and other general merchandise category, we expect to see the relative mix of sales from this category increase. See Supplemental Information below.

Gross profit information is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)		(in millions)	
Gross Profit:				
North America	$ 586	$ 460	$ 1,714	$ 1,333
International	413	302	1,208	850
Consolidated	$ 999	$ 762	$ 2,922	$ 2,183
Gross Profit Growth Rate:				
North America	28%	34%	29%	34%
International	37	47	42	39
Consolidated	31	39	34	36
Gross Margin:				
North America	25.5%	25.7%	26.0%	26.6%
International	21.1	20.5	20.6	20.5
Consolidated	23.4	23.4	23.4	23.8

The increase in gross profit in absolute terms during Q3 2008 compared with the comparable prior year period corresponds with increases in sales, offset by lower prices for customers including from free shipping offers and Amazon Prime. Generally, our gross margins fluctuate based on several factors, including our product, service, and geographic mix of sales; changes in vendor pricing, including the extent to which we receive discounts and allowances; lowering prices for customers, including from competitive pricing decisions; improvements in product sourcing and inventory management; and the extent to which our customers accept our free shipping and Amazon Prime offers. Such free shipping and Amazon Prime offers reduce shipping revenue and reduce our gross margins on retail sales. We view our shipping offers as an effective worldwide marketing tool and intend to continue offering them indefinitely.

Sales of products by marketplace sellers on our websites represented 31% of unit sales for both Q3 2008 and Q3 2007, and 30% and 29% for the nine months ended September 30, 2008 and 2007. Since revenues from these sales are recorded as a net amount, they generally result in lower revenues but higher gross margin per unit. Since we focus on profit dollars rather than margins, we are largely neutral on whether an item is sold by us or by another seller.

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

North America segment gross margins in Q3 2008 and the nine months ended September 30, 2008 decreased compared to the comparable pr