FIRST GLOBAL

FIRST GLOBAL

Global Research

Company Research: Online Retail

Amazon.com

Initiating Coverage

Strong Buy *$ 15*

The Truth about Amazon's Liquidity

February 8, 2001

Analyst: Rahul Khanwalkar Tel.: 91-22-265 2661 Fax: 91-22-265 2702 Email: globalresearch@fglobal.com

First Global (UK) Ltd. a subsidiary, is a member of London Stock Exchange and is regulated by Securities & Futures Authority (SFA), UK

The Truth about Amazon's Liquidity

At the end of FY2000 ended on 31st December, Amazon.com had over ***$1.1 billion in quick assets.*** It implies an addition of $200 million in the 4th quarter. These assets consist of cash and marketable securities.

In the fourth quarter, Amazon reported pro-forma operating losses of $60 million as against losses of $175 million the last year corresponding quarter. For FY2000, the pro-forma Operating losses stood at $317 million as against $352 million in FY99. These statistics lead to 2 deductions:

- Though Amazon continues to make losses, its operating losses were more under control in year 2000 than in the previous year.
- In the most recent quarter, Amazon improved its operations so much so that its losses dropped sharply to a more sustainable level.

Salient features of the Pro-forma statement of Operations:

(Figures in $ mn)	1999 IV Quarter	2000 IV Quarter	Change (%)	1999 Full Year	2000 Full Year	Change (%)
Gross Profit	**88**	**224**	**155**	**291**	**656**	**125**
Pro-forma Operating Loss	(175)	(60)		(352)	(317)	
Pro-forma Net Loss	(185)	(90)		(390)	(417)	
Pro-forma EPS ($)	(0.55)	(0.25)		(1.19)	(1.19)	

● *Free Cash-flow Statement*

(Figures in $ mn)	1999 IV Quarter	2000 IV Quarter	Change (%)	1999 Full Year	2000 Full Year
NOPLAT	-175	-60	–	-389	-354
Operating Cash flow	**74**	**258**	**248**	**-67**	**-73**
Free cash flow from Operations	**-46**	**244**	–	**-355**	**-121**
Total Free Cash flow	**-37**	**255**	–	**-308**	**-91**
Net Free Cash flow	-256	139	–	-385	-136

To begin with, Amazon's ***Gross Margin has shown consistent rise*** in FY2000. For the full year, it stands at 24% as against 18% in FY99. ***With the company's infrastructure well in place now, it is all set to operate at these or even higher Gross Margins in future.***

Among the Operating expenses, ***sales & marketing expenses grew only 4%*** for the quarter, while general & administrative expenses grew 8%. Technology and content related expenses registered the highest growth of 21%. However, the company derives benefits from this developmental expenditure over a long-term. Hence, investors should, in fact, take this increase positively.

In spite of the marketing outlay being more or less the same as that in the 4Q99, Amazon could record 44% higher revenue growth. This bears testimony to Amazon's brilliantly cultivated brand equity.

In a nutshell, Amazon's revenues grew much faster than its operating expenses in the current quarter, a major departure from its historic trends.

● *Current Liabilities*

Amazon's current payables position is as follows:

As on	31/12/99	31/12/2000	Change (%)
Accounts Payable	463	485	5
Accrued Advertising expenses	176	273	55
Interest Payable	25	69	178
Current portion of Long-term debt	14	17	16

Contrary to the fears expressed recently, there is no abnormal increase in Amazon's payable accounts. And with cash reserves much higher than that of the previous year, Amazon will have no difficulty towards fulfilling its obligations.

Accrued advertising expenses increased by 55%. This increase implies that ***Amazon, being one of the largest on line advertisers, was able to extract better credit terms from its online advertising providers. The company's bargaining power vis-à-vis its service providers increased also due to the dwindling fortunes of dot.coms. In a nutshell, it is the company's business strategy and not its inability to pay that explains the rise in accrued advertising expenses.***

Interest payable showed a dramatic increase primarily due to its smaller base in the last year.

On the asset side, ***Amazon doesn't have any receivables as it generates revenues on cash basis.*** Inventories too have dropped from $221 million at the end of FY99 to $175 million, implying unleashing cash. ***Amazon could generate 44% more revenues keeping 21% lower inventory. This kind of lean operation can make one bet for the company's eventual profitability.***

● *Amazon's business restructuring moves*

In what could be interpreted as the first solid signs that Amazon is finally making the right moves, the company has announced a slew of initiatives for its long-term viability. These include:

- Amazon is planning to quit selling some of the unprofitable articles. Though the company did not come out with any specifics, these are most likely to be bulky items for which delivery and fulfillment is costly.
- For the smaller items like books, music, video and toys, the company is working out ways and means for driving the delivery costs further down. One of the solutions includes delivery in bulk rather that on an individual unit basis.

- Amazon has made the first serious attempt to right size the company. Around 1,300 workers, representing 15% of Amazon's workforce, will be laid off in the 1Q2001.
- Amazon's core books, music and video business grew a measly 11% in the 4Q2000. The company plans to regain the tempered momentum in its core and most profitable business.

In our view, the company's financials have never been better than its current position and visibility of its future too is getting clearer by the day. Amazon is all set to evolve into a low margin and high asset turnover business. We maintain our Strong Buy on the stock at its current price of $15.

FIRST GLOBAL (UK) Ltd.

Rivington House, 82, Great Eastern Street,
London EC2A 3JL, United Kingdom
Tel. No: 00-44-207-959 5300
email: uk@fglobal.com