

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 than 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

This document has been prepared and issued by First Global Stockbroking (Pvt) Limited, on the basis of publicly available information, internally developed data and other sources believed to be reliable. This document is approved by First Global (UK) Limited.

This document may not be distributed in the United States or Canada except to major U.S. Institutional investors, as that term is defined in Rule 15a-6 issued pursuant to the Securities and Exchange Act of 1935.

This material is for the personal information of the authorised recipient, and we are not soliciting any action based upon it. The report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal.

Whilst all reasonable care has been taken to ensure the facts stated and the opinions given are fair, neither First Global Stockbroking Private Limited nor First Global (UK) Limited nor any of their affiliates shall be in any way responsible for its contents, nor do they accept any liability for any loss or damage (including without limitation loss of profit) which may arise directly or indirectly from use of or reliance on such information.

First Global and its affiliates and its or their directors, officers and employees including persons involved in the preparation or issuance of these material may at any time have a position or holding in any of the above investments or in a related investment, and may have provided within the previous 12 months, or be currently providing, significant advice or investment services in relation to the investment concerned or a related investment.

First Global and its affiliates may, to the extent permitted under applicable law, have acted upon or used the information prior to or immediately following its publication, provided that we could not reasonably expect any such action to have a material effect on the price.

The value of investments and the income from them may vary and you may realise less than the sum invested. Part of the capital invested may be used to pay that income. In the case of higher volatility investments, these may be subject to sudden and large falls in value and you may realise a large loss equal to the amount invested. Some investments are not readily realisable and investors may have difficulty in selling or realising the investment or obtaining reliable information on the value or risks associated with the investment. Where a security is denominated in a currency other than sterling (for UK investors), changes in exchange rates may have an adverse effect on the value of the security and the income thereon. The past performance of investments referred to above is not necessarily a guide to future performance. The tax treatment of some of the investments mentioned above may change with future legislation. The investment or investment service may not be suitable for all recipients of this publication and any doubts regarding this should be addressed to your broker.

No part of this material may be duplicated in any form and/or redistributed without the prior written consent of First Global. Any reference herein to First Global shall also be deemed to refer, mean and include First Global Stockbroking (Pvt) Limited and First Global (UK) Ltd.

First Global Stockbroking (Pvt) Limited is regulated by The Securities and Exchange Board of India, and is a Member of the National Stock Exchange and Bombay Stock Exchange in India.

First Global (UK) Limited is regulated by SFA and is a Member firm of the London Stock Exchange.