AMAZON COM INC
Form 10-K
January 30, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

or

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

Commission File No. 000-22513

AMAZON.COM, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1646860**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

410 Terry Avenue North

Seattle, Washington 98109-5210

(206) 266-1000

(Address and telephone number, including area code, of registrant s principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, par value $.01 per share	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2012	$ 83,001,105,646
Number of shares of common stock outstanding as of January 18, 2013	454,551,069

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the registrant s definitive proxy statement relating to the Annual Meeting of Shareholders to be held in 2013, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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AMAZON.COM, INC.

PART I

Item 1. ***Business***

This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements based on expectations, estimates, and projections as of the date of this filing. Actual results may differ materially from those expressed in forward-looking statements. See Item 1A of Part I Risk Factors.

Amazon.com, Inc. was incorporated in 1994 in the state of Washington and reincorporated in 1996 in the state of Delaware. Our principal corporate offices are located in Seattle, Washington. We completed our initial public offering in May 1997 and our common stock is listed on the Nasdaq Global Select Market under the symbol AMZN.

As used herein, Amazon.com, we, our, and similar terms include Amazon.com, Inc. and its subsidiaries, unless the context indicates otherwise.

General

Amazon.com opened its virtual doors on the World Wide Web in July 1995 and offers Earth s Biggest Selection. We seek to be Earth s most customer-centric company for four primary customer sets: consumers, sellers, enterprises, and content creators. In addition, we provide services, such as advertising services and co-branded credit card agreements.

We have organized our operations into two principal segments: North America and International. See Item 8 of Part II, Financial Statements and Supplementary Data Note 12 Segment Information. See Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Supplemental Information for supplemental information about our net sales.

Consumers

We serve consumers through our retail websites, and focus on selection, price, and convenience. We design our websites to enable millions of unique products to be sold by us and by third parties across dozens of product categories. Customers access our websites directly and through our mobile websites and apps. We also manufacture and sell Kindle devices. We strive to offer our customers the lowest prices possible through low everyday product pricing and shipping offers, including through membership in Amazon Prime, and to improve our operating efficiencies so that we can continue to lower prices for our customers. We also provide easy-to-use functionality, fast and reliable fulfillment, and timely customer service.

We fulfill customer orders in a number of ways, including through the U.S. and international fulfillment centers and warehouses that we operate, through co-sourced and outsourced arrangements in certain countries, and through digital delivery. We operate customer service centers globally, which are supplemented by co-sourced arrangements. See Item 2 of Part I, Properties.

Sellers

We offer programs that enable sellers to sell their products on our websites and their own branded websites and to fulfill orders through us. We are not the seller of record in these transactions, but instead earn fixed fees, revenue share fees, per-unit activity fees, or some combination thereof.

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Enterprises

We serve developers and enterprises of all sizes through Amazon Web Services (AWS), which provides access to technology infrastructure that enables virtually any type of business.

Content Creators

We serve authors and independent publishers with Kindle Direct Publishing, an online platform that lets independent authors and publishers choose a 70% royalty option and make their books available in the Kindle Store, along with Amazon s own publishing arm, Amazon Publishing. We also offer programs that allow authors, musicians, filmmakers, app developers, and others to publish and sell content.

Competition

Our businesses are rapidly evolving and intensely competitive. Our current and potential competitors include: (1) physical-world retailers, publishers, vendors, distributors, manufacturers, and producers of our products; (2) other online e-commerce and mobile e-commerce sites, including sites that sell or distribute digital content; (3) media companies, web portals, comparison shopping websites, and web search engines, either directly or in collaboration with other retailers; (4) companies that provide e-commerce services, including website development, fulfillment, customer service, and payment processing; (5) companies that provide information storage or computing services or products, including infrastructure and other web services; and (6) companies that design, manufacture, market, or sell consumer electronics, telecommunication, and media devices. We believe that the principal competitive factors in our retail businesses include selection, price, and convenience, including fast and reliable fulfillment. Additional competitive factors for our seller and enterprise services include the quality, speed, and reliability of our services and tools. Many of our current and potential competitors have greater resources, longer histories, more customers, and greater brand recognition. They may secure better terms from suppliers, adopt more aggressive pricing, and devote more resources to technology, infrastructure, fulfillment, and marketing. Other companies also may enter into business combinations or alliances that strengthen their competitive positions.

Intellectual Property

We regard our trademarks, service marks, copyrights, patents, domain names, trade dress, trade secrets, proprietary technologies, and similar intellectual property as critical to our success, and we rely on trademark, copyright, and patent law, trade-secret protection, and confidentiality and/or license agreements with our employees, customers, partners, and others to protect our proprietary rights. We have registered, or applied for the registration of, a number of U.S. and international domain names, trademarks, service marks, and copyrights. Additionally, we have filed U.S. and international patent applications covering certain of our proprietary technology. We have licensed in the past, and expect that we may license in the future, certain of our proprietary rights to third parties.

Seasonality

Our business is affected by seasonality, which historically has resulted in higher sales volume during our fourth quarter, which ends December 31. We recognized 35%, 36%, and 38% of our annual revenue during the fourth quarter of 2012, 2011, and 2010.

Employees

We employed approximately 88,400 full-time and part-time employees at December 31, 2012. However, employment levels fluctuate due to seasonal factors affecting our business. Additionally, we utilize independent contractors and temporary personnel to supplement our workforce, particularly on a seasonal basis. Although we

have works councils and statutory employee representation obligations in certain countries, our employees are not represented by a labor union except where required by law and we consider our employee relations to be good. Competition for qualified personnel in our industry has historically been intense, particularly for software engineers, computer scientists, and other technical staff.

Available Information

Our investor relations website is www.amazon.com/ir and we encourage investors to use it as a way of easily finding information about us. We promptly make available on this website, free of charge, the reports that we file or furnish with the Securities and Exchange Commission (SEC), corporate governance information (including our Code of Business Conduct and Ethics), and select press releases and social media postings.

Executive Officers and Directors

The following tables set forth certain information regarding our Executive Officers and Directors as of January 18, 2013:

Executive Officers

Name	Age	Position
Jeffrey P. Bezos	49	President, Chief Executive Officer, and Chairman of the Board
Jeffrey M. Blackburn	43	Senior Vice President, Business Development
Andrew R. Jassy	45	Senior Vice President, Web Services
Diego Piacentini	52	Senior Vice President, International Consumer Business
Shelley L. Reynolds	48	Vice President, Worldwide Controller, and Principal Accounting Officer
Thomas J. Szkutak	52	Senior Vice President and Chief Financial Officer
H. Brian Valentine	53	Senior Vice President, Ecommerce Platform
Jeffrey A. Wilke	46	Senior Vice President, Consumer Business
David A. Zapolsky	49	Vice President, General Counsel, and Secretary

Jeffrey P. Bezos. Mr. Bezos has been Chairman of the Board of Amazon.com since founding it in 1994 and Chief Executive Officer since May 1996. Mr. Bezos served as President of the Company from founding until June 1999 and again from October 2000 to the present.

Jeffrey M. Blackburn. Mr. Blackburn has served as Senior Vice President, Business Development, since April 2006.

Andrew R. Jassy. Mr. Jassy has served as Senior Vice President, Web Services, since April 2006.

Diego Piacentini. Mr. Piacentini has served as Senior Vice President, International Consumer Business, since February 2012, and as Senior Vice President, International Retail, from January 2007 until February 2012.

Shelley L. Reynolds. Ms. Reynolds has served as Vice President, Worldwide Controller, and Principal Accounting Officer since April 2007.

Thomas J. Szkutak. Mr. Szkutak has served as Senior Vice President and Chief Financial Officer since joining Amazon.com in October 2002.

H. Brian Valentine. Mr. Valentine has served as Senior Vice President, Ecommerce Platform, since joining Amazon.com in September 2006.

Jeffrey A. Wilke. Mr. Wilke has served as Senior Vice President, Consumer Business, since February 2012, and as Senior Vice President, North America Retail, from January 2007 until February 2012.

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David A. Zapolsky. Mr. Zapolsky has served as Vice President, General Counsel, and Secretary since September 2012, and as Vice President and Associate General Counsel for Litigation and Regulatory matters from April 2002 until September 2012.

Board of Directors

Name	Age	Position
Jeffrey P. Bezos	49	President, Chief Executive Officer, and Chairman of the Board
Tom A. Alberg	72	Managing Director, Madrona Venture Group
John Seely Brown	72	Visiting Scholar and Advisor to the Provost, University of Southern California
William B. Gordon	62	Partner, Kleiner Perkins Caufield & Byers
Jamie S. Gorelick	62	Partner, Wilmer Cutler Pickering Hale and Dorr LLP
Alain Monié	62	President and Chief Executive Officer, Ingram Micro Inc.
Jonathan J. Rubinstein	56	Former Chairman and CEO, Palm, Inc.
Thomas O. Ryder	68	Retired, Former Chairman, Reader s Digest Association, Inc.
Patricia Q. Stonesifer	56	Vice Chair, Board of Regents, Smithsonian Institution

Item 1A. ***Risk Factors***

Please carefully consider the following risk factors. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected. In addition, the current global economic climate amplifies many of these risks.

We Face Intense Competition

Our businesses are rapidly evolving and intensely competitive, and we have many competitors in different industries, including retail, e-commerce services, digital content and digital media devices, and web services. Many of our current and potential competitors have greater resources, longer histories, more customers, and greater brand recognition. They may secure better terms from vendors, adopt more aggressive pricing and devote more resources to technology, infrastructure, fulfillment, and marketing.

Competition may intensify as our competitors enter into business combinations or alliances and established companies in other market segments expand into our market segments. In addition, new and enhanced technologies, including search, web services, and digital, may increase our competition. The Internet facilitates competitive entry and comparison shopping, and increased competition may reduce our sales and profits.

Our Expansion Places a Significant Strain on our Management, Operational, Financial and Other Resources

We are rapidly and significantly expanding our global operations, including increasing our product and service offerings and scaling our infrastructure to support our retail and services businesses. This expansion increases the complexity of our business and places significant strain on our management, personnel, operations, systems, technical performance, financial resources, and internal financial control and reporting functions. We may not be able to manage growth effectively, which could damage our reputation, limit our growth and negatively affect our operating results.

Our Expansion into New Products, Services, Technologies and Geographic Regions Subjects Us to Additional Business, Legal, Financial and Competitive Risks

We may have limited or no experience in our newer market segments, and our customers may not adopt our new offerings. These offerings may present new and difficult technology challenges, and we may be subject to

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claims if customers of these offerings experience service disruptions or failures or other quality issues. In addition, profitability, if any, in our newer activities may be lower than in our older activities, and we may not be successful enough in these newer activities to recoup our investments in them. If any of this were to occur, it could damage our reputation, limit our growth and negatively affect our operating results.

We May Experience Significant Fluctuations in Our Operating Results and Growth Rate

We may not be able to accurately forecast our growth rate. We base our expense levels and investment plans on sales estimates. A significant portion of our expenses and investments is fixed, and we may not be able to adjust our spending quickly enough if our sales are less than expected.

Our revenue growth may not be sustainable, and our percentage growth rates may decrease. Our revenue and operating profit growth depends on the continued growth of demand for the products and services offered by us or our sellers, and our business is affected by general economic and business conditions worldwide. A softening of demand, whether caused by changes in customer preferences or a weakening of the U.S. or global economies, may result in decreased revenue or growth.

Our sales and operating results will also fluctuate for many other reasons, including due to risks described elsewhere in this section and the following:

- our ability to retain and increase sales to existing customers, attract new customers, and satisfy our customers demands;
- our ability to retain and expand our network of sellers;
- our ability to offer products on favorable terms, manage inventory, and fulfill orders;
- the introduction of competitive websites, products, services, price decreases, or improvements;
- changes in usage or adoption rates of the Internet, e-commerce, digital media devices and web services, including outside the U.S.;
- timing, effectiveness, and costs of expansion and upgrades of our systems and infrastructure;
- the success of our geographic, service, and product line expansions;
- the outcomes of legal proceedings and claims;
- variations in the mix of products and services we sell;
- variations in our level of merchandise and vendor returns;
- the extent to which we offer free shipping, continue to reduce product prices worldwide, and provide additional benefits to our customers;

the extent to which we invest in technology and content, fulfillment and other expense categories;

increases in the prices of fuel and gasoline, as well as increases in the prices of other energy products and commodities like paper and packing supplies;

the extent to which our equity-method investees record significant operating and non-operating items;

the extent to which operators of the networks between our customers and our websites successfully charge fees to grant our customers unimpaired and unconstrained access to our online services;

our ability to collect amounts owed to us when they become due;

the extent to which use of our services is affected by spyware, viruses, phishing and other spam emails, denial of service attacks, data theft, computer intrusions, outages, and similar events; and

terrorist attacks and armed hostilities.

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We May Not Be Successful in Our Efforts to Expand into International Market Segments

Our international activities are significant to our revenues and profits, and we plan to further expand internationally. In certain international market segments, we have relatively little operating experience and may not benefit from any first-to-market advantages or otherwise succeed. It is costly to establish, develop and maintain international operations and websites and promote our brand internationally. Our international operations may not be profitable on a sustained basis.

In addition to risks described elsewhere in this section, our international sales and operations are subject to a number of risks, including:

- local economic and political conditions;
- government regulation of e-commerce, other online services and electronic devices, and competition, and restrictive governmental actions (such as trade protection measures, including export duties and quotas and custom duties and tariffs), nationalization and restrictions on foreign ownership;
- restrictions on sales or distribution of certain products or services and uncertainty regarding liability for products, services and content, including uncertainty as a result of less Internet-friendly legal systems, local laws, lack of legal precedent, and varying rules, regulations, and practices regarding the physical and digital distribution of media products and enforcement of intellectual property rights;
- business licensing or certification requirements, such as for imports, exports and electronic devices;
- limitations on the repatriation and investment of funds and foreign currency exchange restrictions;
- limited fulfillment and technology infrastructure;
- shorter payable and longer receivable cycles and the resultant negative impact on cash flow;
- laws and regulations regarding consumer and data protection, privacy, network security, encryption, payments, and restrictions on pricing or discounts;
- lower levels of use of the Internet;
- lower levels of consumer spending and fewer opportunities for growth compared to the U.S.;
- lower levels of credit card usage and increased payment risk;
- difficulty in staffing, developing and managing foreign operations as a result of distance, language and cultural differences;

- different employee/employer relationships and the existence of works councils and labor unions;
- laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans and taxes; and
- geopolitical events, including war and terrorism.

As international e-commerce and other online services grow, competition will intensify. Local companies may have a substantial competitive advantage because of their greater understanding of, and focus on, the local customer, as well as their more established local brand names. We may not be able to hire, train, retain, and manage required personnel, which may limit our international growth.

The People s Republic of China (PRC) regulates Amazon s and its affiliates businesses and operations in the PRC through regulations and license requirements restricting (i) foreign investment in the Internet, IT infrastructure, retail, delivery, and other sectors, (ii) Internet content and (iii) the sale of media and other products. For example, in order to meet local ownership and regulatory licensing requirements, www.amazon.cn is operated by PRC companies that are indirectly owned, either wholly or partially, by PRC nationals. Although we believe these structures comply with existing PRC laws, they involve unique risks. There are substantial uncertainties regarding the interpretation of PRC laws and regulations, and it is possible that the PRC

government will ultimately take a view contrary to ours. If our Chinese business interests were found to be in violation of any existing or future PRC laws or regulations or if interpretations of those laws and regulations were to change, the business could be subject to fines and other financial penalties, have licenses revoked or be forced to shut down entirely. In addition, the Chinese businesses and operations may be unable to continue to operate if we or our affiliates are unable to enforce contractual relationships with respect to management and control of such businesses.

If We Do Not Successfully Optimize and Operate Our Fulfillment Centers, Our Business Could Be Harmed

If we do not adequately predict customer demand or otherwise optimize and operate our fulfillment centers successfully, it could result in excess or insufficient inventory or fulfillment capacity, result in increased costs, impairment charges, or both, or harm our business in other ways. A failure to optimize inventory will increase our net shipping cost by requiring long-zone or partial shipments. Orders from several of our websites are fulfilled primarily from a single location, and we have only a limited ability to reroute orders to third parties for drop-shipping. We and our co-sourcers may be unable to adequately staff our fulfillment and customer service centers. As we continue to add fulfillment and warehouse capability or add new businesses with different fulfillment requirements, our fulfillment network becomes increasingly complex and operating it becomes more challenging. If the other businesses on whose behalf we perform inventory fulfillment services deliver product to our fulfillment centers in excess of forecasts, we may be unable to secure sufficient storage space and may be unable to optimize our fulfillment centers. There can be no assurance that we will be able to operate our network effectively.

We rely on a limited number of shipping companies to deliver inventory to us and completed orders to our customers. If we are not able to negotiate acceptable terms with these companies or they experience performance problems or other difficulties, it could negatively impact our operating results and customer experience. In addition, our ability to receive inbound inventory efficiently and ship completed orders to customers also may be negatively affected by inclement weather, fire, flood, power loss, earthquakes, labor disputes, acts of war or terrorism, acts of God and similar factors.

Third parties either drop-ship or otherwise fulfill an increasing portion of our customers orders, and we are increasingly reliant on the reliability, quality and future procurement of their services. Under some of our commercial agreements, we maintain the inventory of other companies, thereby increasing the complexity of tracking inventory and operating our fulfillment centers. Our failure to properly handle such inventory or the inability of these other companies to accurately forecast product demand would result in unexpected costs and other harm to our business and reputation.

The Seasonality of Our Business Places Increased Strain on Our Operations

We expect a disproportionate amount of our net sales to occur during our fourth quarter. If we do not stock or restock popular products in sufficient amounts such that we fail to meet customer demand, it could significantly affect our revenue and our future growth. If we overstock products, we may be required to take significant inventory markdowns or write-offs, which could reduce profitability. We may experience an increase in our net shipping cost due to complimentary upgrades, split-shipments, and additional long-zone shipments necessary to ensure timely delivery for the holiday season. If too many customers access our websites within a short period of time due to increased holiday demand, we may experience system interruptions that make our websites unavailable or prevent us from efficiently fulfilling orders, which may reduce the volume of goods we sell and the attractiveness of our products and services. In addition, we may be unable to adequately staff our fulfillment and customer service centers during these peak periods and delivery and other fulfillment companies and customer service co-sourcers may be unable to meet the seasonal demand. We also face risks described elsewhere in this Item 1A relating to fulfillment center optimization and inventory.

We generally have payment terms with our vendors that extend beyond the amount of time necessary to collect proceeds from our customers. As a result of holiday sales, at December 31 of each year, our cash, cash

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equivalents, and marketable securities balances typically reach their highest level (other than as a result of cash flows provided by or used in investing and financing activities). This operating cycle results in a corresponding increase in accounts payable at December 31. Our accounts payable balance generally declines during the first three months of the year, resulting in a corresponding decline in our cash, cash equivalents, and marketable securities balances.

Our Business Could Suffer if We Are Unsuccessful in Making, Integrating, and Maintaining Commercial Agreements, Strategic Alliances, and Other Business Relationships

We provide e-commerce services to other businesses through our seller programs and other commercial agreements, strategic alliances and business relationships. Under these agreements, we provide technology, fulfillment and other services, as well as enable sellers to offer products or services through our websites and power their websites. These arrangements are complex and require substantial personnel and resource commitments by us, which may limit the agreements we are able to enter into and our ability to integrate and deliver services under them. If we fail to implement, maintain, and develop the components of these commercial relationships, which may include fulfillment, customer service, inventory management, tax collection, payment processing, licensing of third-party software, hardware, and content, and engaging third parties to perform hosting and other services, these initiatives may not be viable. The amount of compensation we receive under certain of these agreements is partially dependent on the volume of the other company s sales. Therefore, if the other company s offering is not successful, the compensation we receive may be lower than expected or the agreement may be terminated. Moreover, we may not be able to enter into additional commercial relationships and strategic alliances on favorable terms. We also may be subject to claims from businesses to which we provide these services if we are unsuccessful in implementing, maintaining or developing these services.

As our agreements terminate, we may be unable to renew or replace these agreements on comparable terms, or at all. We may in the future enter into amendments on less favorable terms or encounter parties that have difficulty meeting their contractual obligations to us, which could adversely affect our operating results.

Our present and future e-commerce services agreements, other commercial agreements, and strategic alliances create additional risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- impairment of other relationships;
- variability in revenue and income from entering into, amending, or terminating such agreements or relationships; and
- difficulty integrating under the commercial agreements.

Our Business Could Suffer if We Are Unsuccessful in Making, Integrating, and Maintaining Acquisitions and Investments

We have acquired and invested in a number of companies, and we may acquire or invest in or enter into joint ventures with additional companies. These transactions create risks such as:

- disruption of our ongoing business, including loss of management focus on existing businesses;
- problems retaining key personnel;
- additional operating losses and expenses of the businesses we acquired or in which we invested;

the potential impairment of tangible assets, such as inventory, and intangible assets and goodwill acquired in the acquisitions;

the potential impairment of customer and other relationships of the company we acquired or in which we invested or our own customers as a result of any integration of operations;

- the difficulty of incorporating acquired technology and rights into our offerings and unanticipated expenses related to such integration;
- the difficulty of integrating a new company s accounting, financial reporting, management, information and information security, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;
- for investments in which an investee s financial performance is incorporated into our financial results, either in full or in part, the dependence on the investee s accounting, financial reporting and similar systems, controls and processes;
- the difficulty of implementing at companies we acquire the controls, procedures and policies appropriate for a larger public company;
- potential unknown liabilities associated with a company we acquire or in which we invest; and
- for foreign transactions, additional risks related to the integration of operations across different cultures and languages, and the economic, political, and regulatory risks associated with specific countries.

As a result of future acquisitions or mergers, we might need to issue additional equity securities, spend our cash, or incur debt, contingent liabilities, or amortization expenses related to intangible assets, any of which could reduce our profitability and harm our business. In addition, valuations supporting our acquisitions and strategic investments could change rapidly given the current global economic climate. We could determine that such valuations have experienced impairments or other-than-temporary declines in fair value which could adversely impact our financial results.

We Have Foreign Exchange Risk

The results of operations of, and certain of our intercompany balances associated with, our international websites are exposed to foreign exchange rate fluctuations. Upon translation, operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. As we have expanded our international operations, our exposure to exchange rate fluctuations has increased. We also hold cash equivalents and/or marketable securities primarily in Euros, Japanese Yen, British Pounds, and Chinese Yuan. If the U.S. Dollar strengthens compared to these currencies, cash equivalents, and marketable securities balances, when translated, may be materially less than expected and vice versa.

The Loss of Key Senior Management Personnel Could Negatively Affect Our Business

We depend on our senior management and other key personnel, particularly Jeffrey P. Bezos, our President, CEO, and Chairman. We do not have key person life insurance policies. The loss of any of our executive officers or other key employees could harm our business.

We Could Be Harmed by Data Loss or Other Security Breaches

As a result of our services being web-based and the fact that we process, store and transmit large amounts of data, including personal information, for our customers, failure to prevent or mitigate data loss or other security breaches, including breaches of our vendors technology and systems, could expose us or our customers to a risk of loss or misuse of such information, adversely affect our operating results, result in litigation or potential liability for us and otherwise harm our business. We use third party technology and systems for a variety of reasons, including, without limitation, encryption and authentication technology, employee email, content delivery to customers, back-office support and other functions. Some subsidiaries had past security breaches, and, although they did not have a material adverse effect on our operating results, there can be no assurance of a similar result in the future. Although we have developed systems and processes that are designed to protect customer information and prevent data loss and other security breaches, including systems and processes designed to reduce the impact of a security breach at a third party vendor, such measures cannot provide absolute security.

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We Face Risks Related to System Interruption and Lack of Redundancy

We experience occasional system interruptions and delays that make our websites and services unavailable or slow to respond and prevent us from efficiently fulfilling orders or providing services to third parties, which may reduce our net sales and the attractiveness of our products and services. If we are unable to continually add software and hardware, effectively upgrade our systems and network infrastructure and take other steps to improve the efficiency of our systems, it could cause system interruptions or delays and adversely affect our operating results.

Our computer and communications systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins, and similar events or disruptions. Any of these events could cause system interruption, delays, and loss of critical data, and could prevent us from accepting and fulfilling customer orders and providing services, which could make our product and service offerings less attractive and subject us to liability. Our systems are not fully redundant and our disaster recovery planning may not be sufficient. In addition, we may have inadequate insurance coverage to compensate for any related losses. Any of these events could damage our reputation and be expensive to remedy.

We Face Significant Inventory Risk

In addition to risks described elsewhere in this Item 1A relating to fulfillment center and inventory optimization by us and third parties, we are exposed to significant inventory risks that may adversely affect our operating results as a result of seasonality, new product launches, rapid changes in product cycles and pricing, defective merchandise, changes in consumer demand and consumer spending patterns, changes in consumer tastes with respect to our products and other factors. We endeavor to accurately predict these trends and avoid overstocking or understocking products we manufacture and/or sell. Demand for products, however, can change significantly between the time inventory or components are ordered and the date of sale. In addition, when we begin selling or manufacturing a new product, it may be difficult to establish vendor relationships, determine appropriate product or component selection, and accurately forecast demand. The acquisition of certain types of inventory or components may require significant lead-time and prepayment and they may not be returnable. We carry a broad selection and significant inventory levels of certain products, such as consumer electronics, and we may be unable to sell products in sufficient quantities or during the relevant selling seasons. Any one of the inventory risk factors set forth above may adversely affect our operating results.

We May Not Be Able to Adequately Protect Our Intellectual Property Rights or May Be Accused of Infringing Intellectual Property Rights of Third Parties

We regard our trademarks, service marks, copyrights, patents, trade dress, trade secrets, proprietary technology, and similar intellectual property as critical to our success, and we rely on trademark, copyright, and patent law, trade secret protection, and confidentiality and/or license agreements with our employees, customers, and others to protect our proprietary rights. Effective intellectual property protection may not be available in every country in which our products and services are made available. We also may not be able to acquire or maintain appropriate domain names in all countries in which we do business. Furthermore, regulations governing domain names may not protect our trademarks and similar proprietary rights. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon, or diminish the value of our trademarks and other proprietary rights.

We may not be able to discover or determine the extent of any unauthorized use of our proprietary rights. Third parties that license our proprietary rights also may take actions that diminish the value of our proprietary rights or reputation. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, the steps we take to protect our intellectual property may not adequately protect our rights or prevent third parties from infringing or misappropriating our proprietary rights.

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We also cannot be certain that others will not independently develop or otherwise acquire equivalent or superior technology or other intellectual property rights.

Other parties also may claim that we infringe their proprietary rights. We have been subject to, and expect to continue to be subject to, claims and legal proceedings regarding alleged infringement by us of the intellectual property rights of third parties. Such claims, whether or not meritorious, may result in the expenditure of significant financial and managerial resources, injunctions against us or the payment of damages. We may need to obtain licenses from third parties who allege that we have infringed their rights, but such licenses may not be available on terms acceptable to us or at all. In addition, we may not be able to obtain or utilize on terms that are favorable to us, or at all, licenses or other rights with respect to intellectual property we do not own. These risks have been amplified by the increase in third parties whose sole or primary business is to assert such claims.

Our digital content offerings depend in part on effective digital rights management technology to control access to digital content. If the digital rights management technology that we use is compromised or otherwise malfunctions, we could be subject to claims, and content providers may be unwilling to include their content in our service.

We Have a Rapidly Evolving Business Model and Our Stock Price Is Highly Volatile

We have a rapidly evolving business model. The trading price of our common stock fluctuates significantly in response to, among other risks, the risks described elsewhere in this Item 1A, as well as:

- changes in interest rates;
- conditions or trends in the Internet and the e-commerce industry;
- quarterly variations in operating results;
- fluctuations in the stock market in general and market prices for Internet-related companies in particular;
- changes in financial estimates by us or securities analysts and recommendations by securities analysts;
- changes in our capital structure, including issuance of additional debt or equity to the public;
- changes in the valuation methodology of, or performance by, other e-commerce or technology companies; and
- transactions in our common stock by major investors and certain analyst reports, news, and speculation.

Volatility in our stock price could adversely affect our business and financing opportunities and force us to increase our cash compensation to employees or grant larger stock awards than we have historically, which could hurt our operating results or reduce the percentage ownership of our existing stockholders, or both.

Government Regulation Is Evolving and Unfavorable Changes Could Harm Our Business

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet, e-commerce, and electronic devices. Existing and future laws and regulations may impede our growth. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, mobile communications, electronic device certification, electronic waste, electronic

contracts and other communications, competition, consumer protection, web services, the provision of online payment services, unencumbered Internet access to our services, the design and operation of websites, and the characteristics and quality of products and services. It is not clear how existing laws governing issues such as property ownership, libel, and personal privacy apply to the Internet, e-commerce, digital content and web services. Jurisdictions may regulate consumer-to-consumer online businesses, including certain aspects of our seller programs. Unfavorable regulations and laws could diminish the demand for our products and services and increase our cost of doing business.

We Do Not Collect Sales or Consumption Taxes in Some Jurisdictions

U.S. Supreme Court decisions restrict the imposition of obligations to collect state and local sales taxes with respect to remote sales. However, an increasing number of states have considered or adopted laws that attempt to impose obligations on out-of-state retailers to collect taxes on their behalf. We support a Federal law that would allow states to require sales tax collection under a nationwide system. More than half of our revenue is already earned in jurisdictions where we collect sales tax or its equivalent. A successful assertion by one or more states or foreign countries requiring us to collect taxes where we do not do so could result in substantial tax liabilities, including for past sales, as well as penalties and interest.

We Could be Subject to Additional Income Tax Liabilities

We are subject to income taxes in the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating and estimating our provision and accruals for these taxes. During the ordinary course of business, there are many transactions for which the ultimate tax determination is uncertain. Our effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by losses incurred in jurisdictions for which we are not able to realize the related tax benefit, by changes in foreign currency exchange rates, by entry into new businesses and geographies and changes to our existing businesses, by acquisitions (including integrations) and investments, by changes in the valuation of our deferred tax assets and liabilities, or by changes in the relevant tax, accounting and other laws, regulations, administrative practices, principles, and interpretations, with a number of countries actively considering changes in this regard. In addition, we are subject to audit in various jurisdictions, and such jurisdictions may assess additional income tax liabilities against us. Although we believe our tax estimates are reasonable, the final outcome of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. Developments in an audit or litigation could have a material effect on our operating results or cash flows in the period or periods for which that development occurs, as well as for prior and subsequent periods.

Our Supplier Relationships Subject Us to a Number of Risks

We have significant suppliers, including licensors, and in some cases, limited or single-sources of supply, that are important to our sourcing, services, manufacturing, and any related ongoing servicing of merchandise and content. We do not have long-term arrangements with most of our suppliers to guarantee availability of merchandise, content, components or services, particular payment terms, or the extension of credit limits. If our current suppliers were to stop selling or licensing merchandise, content, components or services to us on acceptable terms, or delay delivery, including as a result of one or more supplier bankruptcies due to poor economic conditions, as a result of natural disasters or for other reasons, we may be unable to procure alternatives from other suppliers in a timely and efficient manner and on acceptable terms, or at all.

We May be Subject to Risks Related to Government Contracts and Related Procurement Regulations

Our contracts with U.S., as well as state, local and foreign, government entities are subject to various procurement regulations and other requirements relating to their formation, administration and performance. We may be subject to audits and investigations relating to our government contracts and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contract, refunding or suspending of payments, forfeiture of profits, payment of fines and suspension or debarment from future government business. In addition, such contracts may provide for termination by the government at any time, without cause.

We May Be Subject to Product Liability Claims if People or Property Are Harmed by the Products We Sell

Some of the products we sell or manufacture may expose us to product liability claims relating to personal injury, death, or environmental or property damage, and may require product recalls or other actions. Certain

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third parties also sell products using our e-commerce platform that may increase our exposure to product liability claims, such as if these sellers do not have sufficient protection from such claims. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all. In addition, some of our agreements with our vendors and sellers do not indemnify us from product liability.

We Are Subject to Payments-Related Risks

We accept payments using a variety of methods, including credit card, debit card, credit accounts (including promotional financing), gift certificates, direct debit from a customer s bank account, consumer invoicing, physical bank check and payment upon delivery. As we offer new payment options to our customers, we may be subject to additional regulations, compliance requirements, and fraud. For certain payment methods, including credit and debit cards, we pay interchange and other fees, which may increase over time and raise our operating costs and lower profitability. We rely on third parties to provide payment processing services, including the processing of credit cards, debit cards, electronic checks, and promotional financing, and it could disrupt our business if these companies become unwilling or unable to provide these services to us. We are also subject to payment card association operating rules, including data security rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, or if our data security systems are breached or compromised, we may be liable for card issuing banks costs, subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers, process electronic funds transfers, or facilitate other types of online payments, and our business and operating results could be adversely affected. We also offer co-branded credit card programs that represent a significant component of our services revenue. If one or more of these agreements are terminated and we are unable to replace them on similar terms, or at all, it could adversely affect our operating results.

In addition, we qualify as a money services business in certain jurisdictions because we enable customers to keep account balances with us and transfer money to third parties, and because we provide services to third parties to facilitate payments on their behalf. In these jurisdictions, we may be subject to requirements for licensing, regulatory inspection, bonding, the handling of transferred funds and consumer disclosures. We are also subject to or voluntarily comply with a number of other laws and regulations relating to payments, money laundering, international money transfers, privacy and information security and electronic fund transfers. If we were found to be in violation of applicable laws or regulations, we could be subject to additional requirements, such as maintaining capital and segregating funds, and civil and criminal penalties, or forced to cease providing certain services.

We Could Be Liable for Fraudulent or Unlawful Activities of Sellers

The law relating to the liability of providers of online payment services is currently unsettled. In addition, governmental agencies could require changes in the way this business is conducted. Under our seller programs, we may be unable to prevent sellers from collecting payments, fraudulently or otherwise, when buyers never receive the products they ordered or when the products received are materially different from the sellers descriptions. Under our A2Z Guarantee, we reimburse buyers for payments up to certain limits in these situations, and as our marketplace seller sales grow, the cost of this program will increase and could negatively affect our operating results. We also may be unable to prevent sellers on our sites or through other seller sites from selling unlawful goods, from selling goods in an unlawful manner, or violating the proprietary rights of others, and could face civil or criminal liability for unlawful activities by our sellers.

Item 1B. ***Unresolved Staff Comments***

None.

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Item 2. ***Properties***

As of December 31, 2012, we operated the following facilities (in thousands):

Description of Use	Square Footage (1)	Location	Lease Expirations (1)
Owned office space	1,802	North America	
Leased office space	3,236	North America	From 2013 through 2027
Leased office space	1,660	International	From 2013 through 2021
Sub-total	6,698		
Owned fulfillment, datacenters, and other	339	North America	
Leased fulfillment, datacenters, and other	35,261	North America	From 2013 through 2027
Owned fulfillment, datacenters, and other	22	International	
Leased fulfillment, datacenters, and other	30,761	International	From 2013 through 2031
Sub-total	66,383		
Total	73,081		

(1) For leased properties, represents the total leased space excluding sub-leased space.

We own and lease our corporate headquarters in Seattle, Washington. Additionally, we own and lease corporate office, fulfillment and warehouse operations, data center, customer service, and other facilities, principally in North America, Europe, and Asia.

Item 3. ***Legal Proceedings***

See Item 8 of Part II, Financial Statements and Supplementary Data Note 8 Commitments and Contingencies Legal Proceedings.

Item 4. ***Mine Safety Disclosures***

Not applicable.

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PART II

Item 5. ***Market for the Registrant s Common Stock, Related Shareholder Matters and Issuer Purchases of Equity Securities***

Market Information

Our common stock is traded on the Nasdaq Global Select Market under the symbol AMZN. The following table sets forth the high and low per share sale prices for our common stock for the periods indicated, as reported by the Nasdaq Global Select Market.

	High	Low
Year ended December 31, 2011		
First Quarter	$ 191.60	$ 160.59
Second Quarter	206.39	175.37
Third Quarter	244.00	177.10
Fourth Quarter	246.71	166.97
Year ended December 31, 2012		
First Quarter	$ 209.85	$ 172.00
Second Quarter	233.84	183.65
Third Quarter	264.11	212.61
Fourth Quarter	263.11	218.18

Holders

As of January 18, 2013, there were 3,075 shareholders of record of our common stock, although there are a much larger number of beneficial owners.

Dividends

We have never declared or paid cash dividends on our common stock. See Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Recent Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

None.

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Item 6. ***Selected Consolidated Financial Data***

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto in Item 8 of Part II, Financial Statements and Supplementary Data, and the information contained in Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations. Historical results are not necessarily indicative of future results.

	Year Ended December 31,				
	2012	2011	2010	2009	2008
	(in millions, except per share data)				
Statements of Operations:					
Net sales	$ 61,093	$ 48,077	$ 34,204	$ 24,509	$ 19,166
Income from operations	676	862	1,406	1,129	842
Net income (loss)	(39)	631	1,152	902	645
Basic earnings per share (1)	$ (0.09)	$ 1.39	$ 2.58	$ 2.08	$ 1.52
Diluted earnings per share (1)	$ (0.09)	$ 1.37	$ 2.53	$ 2.04	$ 1.49
Weighted average shares used in computation of earnings per share:					
Basic	453	453	447	433	423
Diluted	453	461	456	442	432
Statements of Cash Flows:					
Net cash provided by operating activities	$ 4,180	$ 3,903	$ 3,495	$ 3,293	$ 1,697
Purchases of property and equipment, including internal-use software and website development	(3,785)	(1,811)	(979)	(373)	(333)
Free cash flow (2)	$ 395	$ 2,092	$ 2,516	$ 2,920	$ 1,364

	December 31,				
	2012	2011	2010	2009	2008
	(in millions)				
Balance Sheets:					
Total assets	$ 32,555	$ 25,278	$ 18,797	$ 13,813	$ 8,314
Total long-term obligations	5,361	2,625	1,561	1,192	896

(1) For further discussion of earnings per share, see Item 8 of Part II, Financial Statements and Supplementary Data Note 1 Description of Business and Accounting Policies.

(2) Free cash flow, a non-GAAP financial measure, is defined as net cash provided by operating activities less purchases of property and equipment, including capitalized internal-use software and website development, both of which are presented on our consolidated statements of cash flows. See Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Non-GAAP Financial Measures.

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Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Forward-Looking Statements

This Annual Report on Form 10-K 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 Annual Report on Form 10-K 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 and data center optimization, risks of inventory management, seasonality, the degree to which the Company enters into, maintains, and develops commercial agreements, acquisitions, and strategic transactions, payments risks, and risks of fulfillment throughput and productivity. In addition, the current global economic climate amplifies many of these risks. These risks and uncertainties, as well as other risks and uncertainties that could cause our actual results to differ significantly from management s expectations, are described in greater detail in Item 1A of Part I, 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 consumer-facing websites primarily include merchandise and content we have purchased for resale from vendors and those offered by third-party sellers, and we also manufacture and sell Kindle devices. Generally, we recognize gross revenue from items we sell from our inventory as product sales and recognize our net share of revenue of items sold by other sellers as services sales. We also offer other services such as AWS, fulfillment, publishing, digital content subscriptions, advertising, and co-branded credit cards.

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[2] and capital expenditures. Increases in operating income primarily result from increases in sales of products and services and efficiently managing our operating costs, partially offset by investments we make in longer-term strategic initiatives. To increase sales of products and services, we focus on improving all aspects of the customer experience, including lowering prices, improving availability, offering faster delivery and performance times, increasing selection, increasing product categories and service offerings, expanding product information, improving ease of use, improving reliability, and earning customer trust. We also seek to efficiently manage shareholder dilution while maintaining the flexibility to issue shares for strategic purposes, such as financings, acquisitions, 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 measuring shareholder dilution, we include all vested and unvested stock awards outstanding, without regard to estimated forfeitures. Total shares outstanding plus outstanding stock awards were 470 million and 468 million at December 31, 2012 and 2011.

[1] Free cash flow, a non-GAAP financial measure, is defined as net cash provided by operating activities less purchases of property and equipment, including capitalized internal-use software and website development, both of which are presented on our consolidated statements of cash flows. See Results of Operations Non-GAAP Financial Measures below.

[2] Working capital consists of accounts receivable, inventory, and accounts payable.

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, costs necessary to run AWS, and a portion of our marketing costs. Our fixed costs include the costs necessary to run our technology infrastructure; to build, enhance, and add features to our websites, our Kindle devices, and digital offerings; and to 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 sourcing, increase 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[3]. On average, our high inventory velocity means we generally collect from consumers before our payments to suppliers come due. Inventory turnover[4] was 9, 10, and 11 for 2012, 2011, and 2010. We expect 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 and selection of product offerings, our investment in new geographies and product lines, and the extent to which we choose to utilize outsource fulfillment providers. Accounts payable days[5] were 76, 74, and 72 for 2012, 2011, and 2010. 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 merchandising employees. We seek to efficiently invest in several areas of technology and content such as digital initiatives and expansion of new and existing physical and digital product categories and offerings, as well as in technology infrastructure to enhance the customer experience and improve our process efficiencies. We believe that advances in technology, specifically the speed and reduced cost of processing power and the advances of wireless connectivity, will continue to improve the consumer experience on the Internet and increase its ubiquity in people s lives. To best take advantage of these continued advances in technology, we are investing in initiatives to build and deploy innovative and efficient software and devices. We are also investing in AWS, which provides technology services that give developers and enterprises of all sizes access to technology infrastructure that enables virtually any type of business.

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, 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, and operating expenses will be lower than if currencies had remained constant. We believe that our increasing diversification beyond the U.S. economy through our growing international businesses benefits our shareholders over the long term. We also believe it is useful to evaluate our operating results and growth rates before and after the effect of currency changes.

In addition, the remeasurement of our intercompany balances can result in significant gains and charges associated with the effect of movements in currency exchange rates. Currency volatilities may continue, which

[3] The operating cycle is number of days of sales in inventory plus number of days of sales in accounts receivable minus accounts payable days.
[4] Inventory turnover is the quotient of trailing-twelve-month cost of sales to average inventory over five quarter-ends.
[5] Accounts payable days, calculated as the quotient of accounts payable to current quarter cost of sales, multiplied by the number of days in the current quarter.

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may significantly impact (either positively or negatively) our reported results and consolidated trends and comparisons.

For additional information about each line item summarized above, refer to Item 8 of Part II, Financial Statements and Supplementary Data Note 1 Description of Business and Accounting Policies.

Critical Accounting Judgments

The preparation of financial statements in conformity with generally accepted accounting principles of the United States (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. Although we believe that our estimates, assumptions, and judgments are reasonable, they are based upon information presently available. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions.

Inventories

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

These assumptions about future disposition of inventory are inherently uncertain. As a measure of sensitivity, for every 1% of additional inventory valuation allowance at December 31, 2012 we would have recorded an additional cost of sales of approximately $60 million.

Goodwill

We evaluate goodwill for impairment annually or more frequently when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. Our annual testing date is October 1. We test goodwill for impairment by first comparing the book value of net assets to the fair value of the reporting units. If the fair value is determined to be less than the book value or qualitative factors indicate that it is more likely than not that goodwill is impaired, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value. We estimate the fair value of the reporting units using discounted cash flows. Forecasts of future cash flow are based on our best estimate of future net sales and operating expenses, based primarily on expected category expansion, pricing, market segment share, and general economic conditions. Certain estimates of discounted cash flows involve businesses and geographies with limited financial history and developing revenue models. Changes in these forecasts could significantly change the amount of impairment recorded, if any.

During the year, management monitored the actual performance of the business relative to the fair value assumptions used during our annual goodwill impairment test. For the periods presented, no triggering events were identified that required an update to our annual impairment test. As a measure of sensitivity, a 10% decrease in the fair value of any of our reporting units as of December 31, 2012 would have had no impact on the carrying value of our goodwill.

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Financial and credit market volatility directly impacts our fair value measurement through our weighted average cost of capital that we use to determine our discount rate and through our stock price that we use to determine our market capitalization. During times of volatility, significant judgment must be applied to determine whether credit or stock price changes are a short-term swing or a longer-term trend. As a measure of sensitivity, a prolonged 20% decrease from our December 31, 2012, closing stock price would not be an indicator of possible impairment.

Stock-Based Compensation

We measure compensation cost for stock awards at fair value and recognize it as compensation expense over the service period for awards expected to vest. The fair value of restricted stock units is determined based on the number of shares granted and the quoted price of our common stock. The estimation of stock awards that will ultimately vest requires judgment for the amount that will be forfeited, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including employee class, economic environment, and historical experience. We update our estimated forfeiture rate quarterly. A 1% change to our estimated forfeiture rate would have had an approximately $22 million impact on our 2012 operating income. Our estimated forfeiture rates at December 31, 2012 and 2011, were 27% and 28%.

We utilize the accelerated method, rather than the straight-line method, for recognizing compensation expense. For example, over 50% of the compensation cost related to an award vesting ratably over four years is expensed in the first year. If forfeited early in the life of an award, the compensation expense adjustment is much greater under an accelerated method than under a straight-line method.

Income Taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating and estimating our provision and accruals for these taxes. During the ordinary course of business, there are many transactions for which the ultimate tax determination is uncertain. Our effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by losses incurred in jurisdictions for which we are not able to realize the related tax benefit, by changes in foreign currency exchange rates, by entry into new businesses and geographies and changes to our existing businesses, by acquisitions (including integrations) and investments, by changes in the valuation of our deferred tax assets and liabilities, or by changes in the relevant tax, accounting, and other laws, regulations, administrative practices, principles, and interpretations, with a number of countries actively considering changes in this regard. In addition, we are subject to audit in various jurisdictions, and such jurisdictions may assess additional income tax liabilities against us. Although we believe our tax estimates are reasonable, the final outcome of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. Developments in an audit or litigation could have a material effect on our operating results or cash flows in the period or periods for which that development occurs, as well as for prior and subsequent periods.

Recent Accounting Pronouncements

See Item 8 of Part II, Financial Statements and Supplementary Data Note 1 Description of Business and Accounting Policies Recent Accounting Pronouncements.

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Liquidity and Capital Resources

Cash flow information is as follows (in millions):

	Year Ended December 31,		
	2012	2011	2010
Cash provided by (used in):			
Operating activities	$ 4,180	$ 3,903	$ 3,495
Investing activities	(3,595)	(1,930)	(3,360)
Financing activities	2,259	(482)	181

Our financial focus is on long-term, sustainable growth in free cash flow. Free cash flow, a non-GAAP financial measure, was $395 million for 2012, compared to $2.1 billion and $2.5 billion for 2011 and 2010. See Results of Operations Non-GAAP Financial Measures below for a reconciliation of free cash flow to cash provided by operating activities. The decrease in free cash flow in 2012 and 2011, compared to the comparable prior year periods, was primarily due to increased capital expenditures partially offset by higher operating cash flows. Operating cash flows and free cash flows can be volatile and are sensitive to many factors, including changes in working capital, the timing and magnitude of capital expenditures, and our net income. Working capital at any specific point in time is subject to many variables, including seasonality, inventory management and category expansion, the timing of cash receipts and payments, vendor payment terms, and fluctuations in foreign exchange rates.

Our principal sources of liquidity are cash flows generated from operations and our cash, cash equivalents, and marketable securities balances, which, at fair value, were $11.4 billion, $9.6 billion, and $8.8 billion, at December 31, 2012, 2011, and 2010. Amounts held in foreign currencies were $5.1 billion, $4.1 billion, and $3.4 billion at December 31, 2012, 2011, and 2010, and were primarily Euros, British Pounds, Japanese Yen, and Chinese Yuan.

Cash provided by operating activities was $4.2 billion, $3.9 billion, and $3.5 billion in 2012, 2011, and 2010. Our operating cash flows result primarily from cash received from our consumer, seller, and enterprise customers, advertising agreements, and our co-branded credit card agreements, offset by cash payments we make for products and services, employee compensation (less amounts capitalized related to internal use software that are reflected as cash used in investing activities), payment processing and related transaction costs, operating leases, and interest payments on our long-term obligations. Cash received from our consumer, seller, and enterprise customers, and other activities generally corresponds to our net sales. Because consumers primarily use credit cards to buy from us, our receivables from consumers settle quickly. The increase in operating cash flow in 2012, compared to the comparable prior year period, was primarily due to increases in non-cash expenses partially offset by the decrease in net income; additions to unearned revenue; and changes in working capital; partially offset by increased tax benefits on excess stock-based compensation deductions. The increase in operating cash flow in 2011, compared to the comparable prior year period, was primarily due to additions to unearned revenue; increases in sales of gift certificates to our customers; decreased tax benefits on excess stock-based compensation deductions; and the increase in net income, excluding depreciation, amortization, and stock-based compensation; partially offset by changes in working capital.

Cash provided by (used in) investing activities corresponds with capital expenditures, including leasehold improvements, internal-use software and website development costs, cash outlays for acquisitions, investments in other companies and intellectual property rights, and purchases, sales, and maturities of marketable securities. Cash used in investing activities was $(3.6) billion, $(1.9) billion, and $(3.4) billion in 2012, 2011, and 2010, with the variability caused primarily by changes in capital expenditures and changes in cash paid for acquisitions, and purchases, maturities, and sales of marketable securities and other investments. Capital expenditures were $3.8 billion, $1.8 billion, and $979 million in 2012, 2011, and 2010, with the increases primarily reflecting the purchase of property in 2012, and additional investments in support of continued business growth due to investments in technology infrastructure, including AWS, and additional capacity to support our fulfillment

operations during all three periods. We expect this trend to continue over time. The purchase of property in 2012 included the acquisition of 11 buildings comprising 1.8 million square feet of our previously leased corporate office space and three city blocks in Seattle, Washington for $1.4 billion. Capital expenditures included $381 million, $256 million, and $176 million for internal-use software and website development during 2012, 2011, and 2010. Stock-based compensation capitalized for internal-use software and website development costs does not affect cash flows. In 2012, 2011, and 2010, we made cash payments, net of acquired cash, related to acquisition and other investment activity of $745 million, $705 million, and $352 million.

Cash provided by (used in) financing activities was $2.3 billion, $(482) million, and $181 million in 2012, 2011, and 2010. Cash outflows from financing activities result from repurchases of common stock, payments on obligations related to capital leases and leases accounted for as financing arrangements, and repayments of long-term debt. Payments on obligations related to capital leases and leases accounted for as financing arrangements and repayments of long-term debt, were $588 million, $444 million, and $221 million in 2012, 2011, and 2010. We repurchased 5.3 million shares of common stock for $960 million in 2012 and 1.5 million shares of common stock for $277 million in 2011 under the $2.0 billion repurchase program authorized by our Board of Directors in January 2010. Cash inflows from financing activities primarily result from proceeds from long-term debt and tax benefits relating to excess stock-based compensation deductions. Proceeds from long-term debt and other were $3.4 billion, $177 million, and $143 million in 2012, 2011, and 2010. During 2012, cash inflows from financing activities consisted primarily of net proceeds from the issuance of $3.0 billion of senior nonconvertible unsecured debt in three tranches: $750 million of 0.65% notes due in 2015; $1.0 billion of 1.20% notes due in 2017; and $1.3 billion of 2.50% notes due in 2022. See Item 8 of Part II, Financial Statements and Supplementary Data Note 6 Long-Term Debt for additional discussion of the notes. Tax benefits relating to excess stock-based compensation deductions are presented as financing cash flows. Cash inflows from tax benefits related to stock-based compensation deductions were $429 million, $62 million, and $259 million in 2012, 2011, and 2010.

In 2012, 2011, and 2010 we recorded net tax provisions of $428 million, $291 million, and $352 million. A majority of this provision is non-cash. We have tax benefits relating to excess stock-based compensation deductions that are being utilized to reduce our U.S. taxable income. Except as required under U.S. tax law, we do not provide for U.S. taxes on our undistributed earnings of foreign subsidiaries that have not been previously taxed since we intend to invest such undistributed earnings indefinitely outside of the U.S. If our intent changes or if these funds are needed for our U.S. operations, we would be required to accrue or pay U.S. taxes on some or all of these undistributed earnings. At December 31, 2012, cash held by foreign subsidiaries was $4.3 billion, which include undistributed earnings of foreign subsidiaries indefinitely invested outside of the U.S. of $2.1 billion. Cash taxes paid (net of refunds) were $112 million, $33 million, and $75 million for 2012, 2011, and 2010. As of December 31, 2012, our federal net operating loss carryforward was approximately $89 million. We also have approximately $136 million of federal tax credits potentially available to offset future tax liabilities. As we utilize our federal tax credits, we expect cash paid for taxes to significantly increase. We endeavor to optimize our global taxes on a cash basis, rather than on a financial reporting basis.

See Item 8 of Part II, Financial Statements and Supplementary Data Note 8 Commitments and Contingencies for additional discussion of our principal contractual commitments, as well as our pledged securities. Purchase obligations and open purchase orders, consisting of inventory and significant non-inventory commitments, were $3.8 billion at December 31, 2012. Purchase obligations and open purchase orders are generally cancelable in full or in part through the contractual provisions.

On average, our high inventory velocity means we generally collect from consumers before our payments to suppliers come due. Inventory turnover was 9, 10, and 11 for 2012, 2011, and 2010. We expect 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 and selection of product offerings, our investment in new geographies and product lines, and the extent to which we choose to utilize outsource fulfillment providers.

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We believe that cash flows generated from operations and our 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 I, Risk Factors. We continually evaluate opportunities to sell additional equity or debt securities, obtain credit facilities, repurchase common stock, pay dividends, or repurchase, refinance, or otherwise restructure our debt for strategic reasons or to further strengthen our financial position. The sale of additional equity or convertible debt securities would likely be dilutive to our shareholders. In addition, we will, from time to time, consider the acquisition of, or investment in, complementary businesses, products, services, and technologies, which might affect our liquidity requirements or cause us to issue additional equity or debt securities. There can be no assurance that additional lines-of-credit or financing instruments will be available in amounts or on terms acceptable to us, if at all.

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 Officer reviews our operating results in assessing performance and allocating resources.

Net Sales

Net sales include product and services sales. Product sales represent revenue from the sale of products and related shipping fees and digital content where we are the seller of record. Services sales represent third-party seller fees earned (including commissions) and related shipping fees, digital content subscriptions, and non-retail activities. Net sales information is as follows (in millions):

	Year Ended December 31,		
	2012	**2011**	**2010**
Net Sales:			
North America	$ 34,813	$ 26,705	$ 18,707
International	26,280	21,372	15,497
Consolidated	$ 61,093	$ 48,077	$ 34,204
Year-over-year Percentage Growth:			
North America	30%	43%	46%
International	23	38	33
Consolidated	27	41	40
Year-over-year Percentage Growth, excluding effect of exchange rates:			
North America	30%	43%	46%
International	27	31	34
Consolidated	29	37	40
Net Sales Mix:			
North America	57%	56%	55%
International	43	44	45
Consolidated	100%	100%	100%

Sales increased 27%, 41%, and 40% in 2012, 2011, and 2010, compared to the comparable prior year periods. Changes in currency exchange rates impacted net sales by $(854) million, $1.1 billion, and $(86) million for 2012, 2011, and 2010. For a discussion of the effect on sales growth of exchange rates, see Effect of Exchange Rates below.

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North America sales grew 30%, 43%, and 46% in 2012, 2011, and 2010, compared to the comparable prior year periods. The sales growth in each year primarily reflects increased unit sales, partially offset by a higher percentage of sales by marketplace sellers. Increased unit sales were driven largely by our continued efforts to reduce prices for our customers, including from our shipping offers, by sales in faster growing categories such as electronics and other general merchandise, by increased in-stock inventory availability, and by increased selection of product offerings.

International sales grew 23%, 38%, and 33% in 2012, 2011, and 2010, compared to the comparable prior year periods. The sales growth in each year primarily reflects increased unit sales, partially offset by a higher percentage of sales by marketplace sellers. Increased unit sales were driven largely by our continued efforts to reduce prices for our customers, including from our shipping offers, by sales in faster growing categories such as electronics and other general merchandise, by increased in-stock inventory availability, and by increased selection of product offerings. Additionally, changes in currency exchange rates impacted International net sales by $(853) million, $1.1 billion, and $(107) million in 2012, 2011, and 2010. We expect that, over time, our International segment will represent 50% or more of our consolidated net sales.

Supplemental Information

Supplemental information about shipping results is as follows (in millions):

	Year Ended December 31,		
	2012	**2011**	**2010**
Shipping Activity:			
Shipping revenue (1)(2)(3)	$ 2,280	$ 1,552	$ 1,193
Outbound shipping costs	(5,134)	(3,989)	(2,579)
Net shipping cost	$ (2,854)	$ (2,437)	$ (1,386)
Year-over-year Percentage Growth:			
Shipping revenue	47%	30%	29%
Outbound shipping costs	29	55	45
Net shipping cost	17	76	63
Percent of Net Sales:			
Shipping revenue	3.7%	3.2%	3.5%
Outbound shipping costs	(8.4)	(8.3)	(7.5)
Net shipping cost	(4.7)%	(5.1)%	(4.0)%

(1) Excludes amounts earned on shipping activities by third-party sellers where we do not provide the fulfillment service.
(2) Includes a portion of amounts earned from Amazon Prime memberships.
(3) Shipping revenue for the year ended December 31, 2012, includes amounts earned from Fulfillment by Amazon programs related to shipping services.

We expect our net cost of shipping to continue to increase to the extent our customers accept and use our shipping offers at an increasing rate, our product mix shifts to the electronics and other general merchandise category, we reduce shipping rates, we use more expensive shipping methods, and we offer additional services. We seek to mitigate costs of shipping over time in part through achieving higher sales volumes, optimizing placement of fulfillment centers, negotiating better terms with our suppliers, and achieving better operating efficiencies. We believe that offering low prices to our customers is fundamental to our future success, and one way we offer lower prices is through shipping offers.

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Net sales by similar products and services were as follows (in millions):

	Year Ended December 31,		
	2012	**2011**	**2010**
Net Sales:			
North America			
Media	$ 9,189	$ 7,959	$ 6,881
Electronics and other general merchandise	23,273	17,315	10,998
Other (1)	2,351	1,431	828
Total North America	$ 34,813	$ 26,705	$ 18,707
International			
Media	$ 10,753	$ 9,820	$ 8,007
Electronics and other general merchandise	15,355	11,397	7,365
Other (1)	172	155	125
Total International	$ 26,280	$ 21,372	$ 15,497
Consolidated			
Media	$ 19,942	$ 17,779	$ 14,888
Electronics and other general merchandise	38,628	28,712	18,363
Other (1)	2,523	1,586	953
Total consolidated	$ 61,093	$ 48,077	$ 34,204
Year-over-year Percentage Growth:			
North America			
Media	15%	16%	15%
Electronics and other general merchandise	34	57	74
Other	64	73	50
Total North America	30	43	46
International			
Media	9%	23%	18%
Electronics and other general merchandise	35	55	54
Other	11	24	22
Total International	23	38	33
Consolidated			
Media	12%	19%	17%
Electronics and other general merchandise	35	56	66
Other	59	66	46
Total consolidated	27	41	40
Year-over-year Percentage Growth:			
Excluding the effect of exchange rates			
International			
Media	12%	16%	18%
Electronics and other general merchandise	40	47	57
Other	15	18	24
Total International	27	31	34
Consolidated			
Media	14%	16%	16%
Electronics and other general merchandise	36	53	67
Other	59	66	46
Total consolidated	29	37	40

Consolidated Net Sales Mix:			
Media	33%	37%	43%
Electronics and other general merchandise	63	60	54
Other	4	3	3
Total consolidated	100%	100%	100%

(1) Includes sales from non-retail activities, such as AWS in the North America segment, advertising services, and our co-branded credit card agreements in both segments.

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Operating Expenses

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

	Year Ended December 31, 2012			Year Ended December 31, 2011			Year Ended December 31, 2010		
	As Reported	**Stock-Based Compensation**	**Net**	**As Reported**	**Stock-Based Compensation**	**Net**	**As Reported**	**Stock-Based Compensation**	**Net**
Operating Expenses:									
Cost of sales	$ 45,971	$	$ 45,971	$ 37,288	$	$ 37,288	$ 26,561	$	$ 26,561
Fulfillment	6,419	(212)	6,207	4,576	(133)	4,443	2,898	(90)	2,808
Marketing	2,408	(61)	2,347	1,630	(39)	1,591	1,029	(27)	1,002
Technology and content	4,564	(434)	4,130	2,909	(292)	2,617	1,734	(223)	1,511
General and administrative	896	(126)	770	658	(93)	565	470	(84)	386
Other operating expense (income), net	159		159	154		154	106		106
Total operating expenses	$ 60,417	$ (833)	$ 59,584	$ 47,215	$ (557)	$ 46,658	$ 32,798	$ (424)	$ 32,374
Year-over-year Percentage Growth:									
Fulfillment	40%		40%	58%		58%	41%		42%
Marketing	48		47	58		59	51		52
Technology and content	57		58	68		73	40		43
General and administrative	36		36	40		46	44		45
Percent of Net Sales:									
Fulfillment	10.5%		10.2%	9.5%		9.2%	8.5%		8.2%
Marketing	3.9		3.8	3.4		3.3	3.0		2.9
Technology and content	7.5		6.8	6.1		5.4	5.1		4.4
General and administrative	1.5		1.3	1.4		1.2	1.4		1.1

Operating expenses without stock-based compensation are non-GAAP financial measures. See Non-GAAP Financial Measures and Item 8 of Part I, Financial Statements and Supplementary Data Note 1 Description of Business and Accounting Policies Stock-Based Compensation.

Cost of Sales

Cost of sales consists of the purchase price of consumer products and digital content where we are the seller of record, including Prime Instant Video, inbound and outbound shipping charges, and packaging supplies. Shipping charges to receive products from our suppliers are included in our inventory, and recognized as cost of sales upon sale of products to our customers.

The increase in cost of sales in absolute dollars in 2012, 2011, and 2010 compared to the comparable prior year periods, is primarily due to increased product, digital content, and shipping costs resulting from increased sales, as well as from expansion of digital offerings.

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

	Year Ended December 31,		
	2012	**2011**	**2010**
Gross profit (in millions)	$ 15,122	$ 10,789	$ 7,643
Gross margin	24.8%	22.4%	22.3%

Gross margin increased in 2012, compared to the comparable prior year periods, primarily due to services sales increasing as a percentage of total sales. We believe that income from operations is a more meaningful measure than gross profit and gross margin due to the diversity of our product categories and services.

Fulfillment

Fulfillment costs as a percentage of net sales may vary due to several factors, such as payment processing and related transaction costs, our level of productivity and accuracy, changes in volume, size, and weight of units received and fulfilled, timing of fulfillment capacity expansion, the extent we utilize fulfillment services provided by third parties, mix of products and services sold, and our ability to affect customer service contacts per unit by implementing improvements in our operations and enhancements to our customer self-service features. Additionally, because payment processing and fulfillment costs associated with seller transactions are based on the gross purchase price of underlying transactions, and payment processing and related transaction and fulfillment costs are higher as a percentage of sales versus our retail sales, sales by our sellers have higher fulfillment costs as a percent of net sales.

The increase in fulfillment costs in absolute dollars in 2012, 2011, and 2010, compared to the comparable prior year periods, is primarily due to variable costs corresponding with increased physical and digital product and services sales volume, inventory levels, and sales mix; costs from expanding fulfillment capacity; and payment processing and related transaction costs.

We seek to expand our fulfillment capacity to accommodate greater selection and in-stock inventory levels and meet anticipated shipment volumes from sales of our own products as well as sales by third parties for which we provide the fulfillment services. We evaluate our facility requirements as necessary.

Marketing

We direct customers to our websites primarily through a number of targeted online marketing channels, such as our Associates program, sponsored search, portal advertising, email marketing campaigns, and other initiatives. Our marketing expenses are largely variable, based on growth in sales and changes in rates. To the extent there is increased or decreased competition for these traffic sources, or to the extent our mix of these channels shifts, we would expect to see a corresponding change in our marketing expense.

The increase in marketing costs in absolute dollars in 2012, 2011, and 2010, compared to the comparable prior year periods, is primarily due to increased spending on online marketing channels, such as sponsored search programs and our Associates program, payroll and related expenses, and television advertising.

While costs associated with Amazon Prime memberships and other shipping offers are not included in marketing expense, we view these offers as effective worldwide marketing tools, and intend to continue offering them indefinitely.

Technology and Content

We seek to efficiently invest in several areas of technology and content such as technology infrastructure, including AWS, digital initiatives, and expansion of new and existing physical and digital product categories and offerings, so we may continue to enhance the customer experience and improve our process efficiency. We expect spending in technology and content to increase over time as we continue to add employees and technology infrastructure.

The increase in technology and content costs in absolute dollars in 2012, 2011, and 2010 compared to the comparable prior year periods is primarily due to increases in payroll and related expenses, including those associated with our digital initiatives, and increased spending on technology infrastructure, including AWS. We expect these trends to continue over time as we invest in these areas by increasing payroll and related expenses and adding technology infrastructure.

For 2012, 2011, and 2010, we capitalized $454 million (including $74 million of stock-based compensation), $307 million (including $51 million of stock-based compensation), and $213 million (including

$38 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $327 million, $236 million, and $184 million for 2012, 2011, and 2010. A majority of our technology costs are incurred in the U.S., most of which are allocated to our North America segment. Infrastructure, other technology, and operating costs incurred to support AWS are included in technology and content.

General and Administrative

The increase in general and administrative costs in absolute dollars in 2012, 2011, and 2010 compared to the comparable prior year periods is primarily due to increases in payroll and related expenses and professional service fees.

Stock-Based Compensation

Stock-based compensation was $833 million, $557 million, and $424 million during 2012, 2011, and 2010. The increase in 2012, 2011, and 2010 compared to the comparable prior year periods is primarily due to an increase in total stock-based compensation value granted to our employees and to a decrease in our estimated forfeiture rate.

Other Operating Expense (Income), Net

Other operating expense (income), net was $159 million, $154 million, and $106 million during 2012, 2011, and 2010. In 2012, 2011, and 2010, the amounts primarily related to amortization of intangible assets.

Income from Operations

For the reasons discussed above, income from operations decreased 22% in 2012, decreased 39% in 2011, and increased 25% in 2010.

Interest Income and Expense

Our interest income was $40 million, $61 million, and $51 million during 2012, 2011, and 2010. We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market funds. Our interest income corresponds with the average balance of invested funds and the prevailing rates we are earning on them, which vary depending on the geographies and currencies in which they are invested.

The primary component of our interest expense is related to our long-term debt and capital and financing lease arrangements. Interest expense was $92 million, $65 million, and $39 million in 2012, 2011, and 2010.

Our long-term debt was $3.1 billion and $255 million at December 31, 2012 and 2011. Our other long-term liabilities were $2.3 billion and $2.4 billion at December 31, 2012 and 2011. See Item 8 of Part II, Financial Statements and Supplementary Data Note 6 Long-Term Debt and Note 7 Other Long-Term Liabilities for additional information.

Other Income (Expense), Net

Other income (expense), net was $(80) million, $76 million, and $79 million during 2012, 2011, and 2010. The primary component of other income (expense), net, is related to foreign-currency gains (losses) on intercompany balances.

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Income Taxes

Our effective tax rate is subject to significant variation due to several factors, including variability in our pre-tax and taxable income and loss and the mix of jurisdictions to which they relate, changes in how we do business, acquisitions (including integrations) and investments, audit developments, foreign currency gains (losses), changes in law, regulations, and administrative practices, and relative changes of expenses or losses for which tax benefits are not recognized.

We recorded a provision for income taxes of $428 million, $291 million, and $352 million in 2012, 2011, and 2010. Our effective tax rate in 2012, 2011, and 2010 is significantly affected by two factors: the favorable impact of earnings in lower tax rate jurisdictions and the adverse effect of losses incurred in certain foreign jurisdictions for which we may not realize a tax benefit. Income earned in lower tax jurisdictions is primarily related to our European operations, which are headquartered in Luxembourg. Losses incurred in foreign jurisdictions for which we may not realize a tax benefit, primarily generated by subsidiaries located outside of Europe, reduce our pre-tax income without a corresponding reduction in our tax expense, and therefore increase our effective tax rate. We have recorded a valuation allowance against the related deferred tax assets.

In 2012, the adverse impact of such foreign jurisdiction losses was partially offset by the favorable impact of earnings in lower tax rate jurisdictions. Additionally, our effective tax rate in 2012 was more volatile as compared to prior years due to the lower level of pre-tax income generated during the year, relative to our tax expense. Our effective tax rate in 2012 was also adversely impacted by acquisitions (including integrations) and investments, audit developments, nondeductible expenses, and changes in tax law such as the expiration of the U.S. federal research and development credit at the end of 2011. These items collectively caused our annual effective tax rate to be higher than both the 35% U.S. federal statutory rate and our effective tax rates in 2011 and 2010. These items may also cause our effective tax rate in 2013 to be higher than the 35% U.S. federal statutory rate.

In 2011 and 2010, the favorable impact of earnings in lower tax rate jurisdictions offset the adverse impact of foreign jurisdiction losses and, as a result, the effective tax rate in both years was lower than the 35% U.S. federal statutory rate.

We have tax benefits relating to excess stock-based compensation deductions that are being utilized to reduce our U.S. taxable income. As of December 31, 2012, our federal net operating loss carryforward was approximately $89 million. We also have approximately $136 million of federal tax credits potentially available to offset future tax liabilities.

In January 2013, legislation was enacted to extend the federal research and development credit and other favorable tax benefits through December 31, 2013. As a result, we expect that our income tax provision for the first quarter of 2013 will include a discrete tax benefit for the research and development credit and other favorable tax benefits that were extended retroactively to January 1, 2012.

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Equity-Method Investment Activity, Net of Tax

Equity-method investment activity, net of tax, was $(155) million, $(12) million, and $7 million in 2012, 2011, and 2010. Details of the activity are provided below (in millions):

	Year Ended December 31,		
	2012	2011	2010
Equity in earnings (loss) of LivingSocial:			
Impairment charges recorded by LivingSocial	$ (170)	$	$
Gain on existing equity interests, LivingSocial acquisitions	75		
Operating and other losses	(96)	(178)	(2)
Total equity in earnings (loss) of LivingSocial	(191)	(178)	(2)
Other equity-method investment activity:			
Amazon dilution gains on LivingSocial investment	37	114	
Recovery on sale of equity position		49	
Gain on existing equity interests, Amazon acquisitions		6	18
Other, net	(1)	(3)	(9)
Total other equity-method investment activity	36	166	9
Equity-method investment activity, net of tax	$ (155)	$ (12)	$ 7

Effect of Exchange Rates

The effect on our consolidated statements of operations from changes in exchange rates versus the U.S. Dollar is as follows (in millions, except per share data):

	Year Ended December 31, 2012			Year Ended December 31, 2011			Year Ended December 31, 2010		
	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported	At Prior Year Rates (1)	Exchange Rate Effect (2)	As Reported
Net sales	$ 61,947	$ (854)	$ 61,093	$ 46,985	$ 1,092	$ 48,077	$ 34,290	$ (86)	$ 34,204
Operating expenses	61,257	(840)	60,417	46,176	1,039	47,215	32,856	(58)	32,798
Income from operations	690	(14)	676	809	53	862	1,434	(28)	1,406

(1) Represents the outcome that would have resulted had exchange rates in the reported period been the same as those in effect in the comparable prior year period for operating results.
(2) Represents the increase or decrease in reported amounts resulting from changes in exchange rates from those in effect in the comparable prior year period for operating results.

Non-GAAP Financial Measures

Regulation G, *Conditions for Use of Non-GAAP Financial Measures*, and other SEC regulations define and prescribe the conditions for use of certain non-GAAP financial information. Our measures of Free cash flow, operating expenses with and without stock-based compensation, and the effect of exchange rates on our consolidated statements of operations, meet the definition of non-GAAP financial measures.

Free cash flow is used in addition to and in conjunction with results presented in accordance with GAAP and free cash flow should not be relied upon to the exclusion of GAAP financial measures.

Free cash flow, which we reconcile to Net cash provided by (used in) operating activities, is cash flow from operations reduced by Purchases of property and equipment, including internal-use software and website

development. We use free cash flow, and ratios based on it, to conduct and evaluate our business because, although it is similar to cash flow from operations, we believe it typically will present a more conservative measure of cash flows since purchases of property and equipment are a necessary component of ongoing operations.

Free cash flow has limitations due to the fact that it does not represent the residual cash flow available for discretionary expenditures. For example, free cash flow does not incorporate the portion of payments representing principal reductions of debt, obligations related to capital leases and leases accounted for as financing arrangements, or cash payments for business acquisitions. Therefore, we believe it is important to view free cash flow as a complement to our entire consolidated statements of cash flows.

The following is a reconciliation of free cash flow to the most comparable GAAP measure, Net cash provided by (used in) operating activities for 2012, 2011, and 2010 (in millions):

	Year Ended December 31,		
	2012	2011	2010
Net cash provided by operating activities	$ 4,180	$ 3,903	$ 3,495
Purchases of property and equipment, including internal-use software and website development	(3,785)	(1,811)	(979)
Free cash flow	$ 395	$ 2,092	$ 2,516
Net cash used in investing activities	$ (3,595)	$ (1,930)	$ (3,360)
Net cash provided by (used in) financing activities	$ 2,259	$ (482)	$ 181

Operating expenses with and without stock-based compensation is provided to show the impact of stock-based compensation, which is non-cash and excluded from our internal operating plans and measurement of financial performance (although we consider the dilutive impact to our shareholders when awarding stock-based compensation and value such awards accordingly). In addition, unlike other centrally-incurred operating costs, stock-based compensation is not allocated to segment results and therefore excluding it from operating expense is consistent with our segment presentation in our footnotes to the consolidated financial statements.

Operating expenses without stock-based compensation has limitations since it does not include all expenses primarily related to our workforce. More specifically, if we did not pay out a portion of our compensation in the form of stock-based compensation, our cash salary expense included in the Fulfillment, Technology and content, Marketing, and General and administrative line items would be higher.

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

Guidance

We provided guidance on January 29, 2013 in our earnings release furnished on Form 8-K as set forth below. These forward-looking statements reflect Amazon.com s expectations as of January 29, 2013, and are subject to substantial uncertainty. Our results are inherently unpredictable and may be materially affected by many factors, such as 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, as well as those outlined in Item 1A of Part I, Risk Factors.

First Quarter 2013 Guidance

Net sales are expected to be between $15.0 billion and $16.6 billion, or to grow between 14% and 26% compared with first quarter 2012.

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Operating income (loss) is expected to be between $(285) million and $65 million, compared to $192 million in the prior year period.

This guidance includes approximately $285 million for stock-based compensation and amortization of intangible assets, and it assumes, among other things, that no additional business acquisitions or investments are concluded and that there are no further revisions to stock-based compensation estimates.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

We are exposed to market risk for the effect of interest rate changes, foreign currency fluctuations, and changes in the market values of our investments. Information relating to quantitative and qualitative disclosures about market risk is set forth below and in Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and our long-term debt. All of our cash equivalent and marketable fixed income securities are designated as available for sale and, accordingly, are presented at fair value on our consolidated balance sheets. We generally invest our excess cash in investment grade short- to intermediate-term fixed income securities and AAA-rated money market funds. Fixed rate securities may have their fair market value adversely affected due to a rise in interest rates, and we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates.

The following table provides information about our current and long-term cash equivalent and marketable fixed income securities, including principal cash flows by expected maturity and the related weighted average interest rates at December 31, 2012 (in millions, except percentages):

	2013	2014	2015	2016	2017	Thereafter	Total	Estimated Fair Value at December 31, 2012
Money market funds	$ 5,561	$	$	$	$	$	$ 5,561	$ 5,561
Weighted average interest rate	0.12%	0.00%	0.00%	0.00%	0.00%	0.00%	0.12%	
Corporate debt securities	223	243	204	27			697	725
Weighted average interest rate	0.45%	0.62%	0.84%	1.25%	0.00%	0.00%	0.65%	
U.S. Government and Agency Securities	771	561	433	20	5		1,790	1,810
Weighted average interest rate	0.30%	0.43%	0.65%	1.12%	1.00%	0.00%	0.43%	
Asset backed securities	26	16	7				49	49
Weighted average interest rate	0.48%	0.69%	0.67%	0.00%	0.00%	0.00%	0.58%	
Foreign government and agency securities	141	228	340	30			739	772
Weighted average interest rate	0.18%	0.10%	0.12%	0.06%	0.00%	0.00%	0.12%	
Other securities	8	9	10	5			32	33
Weighted average interest rate	0.88%	0.68%	0.80%	1.08%	0.00%	0.00%	0.83%	
	$ 6,730	$ 1,057	$ 994	$ 82	$ 5	$	$ 8,868	
Cash equivalents and marketable fixed-income securities								$ 8,950

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At December 31, 2012, we had $3.7 billion of debt, including the current portion, primarily consisting of fixed rate unsecured debt in three tranches: $750 million of 0.65% notes due in 2015; $1.0 billion of 1.20% notes due in 2017; and $1.3 billion of 2.50% notes due in 2022. The fair value of our debt will fluctuate with movements of interest rates, increasing in periods of declining rates of interest and declining in periods of increasing rates of interest. Based upon quoted market prices and Level 2 inputs, the fair value of our debt was $3.7 billion at December 31, 2012.

Foreign Exchange Risk

During 2012, net sales from our International segment accounted for 43% of our consolidated revenues. Net sales and related expenses generated from our international websites, as well as those relating to www.amazon.ca (which is included in our North America segment), are denominated in the functional currencies of the corresponding websites and primarily include Euros, British Pounds, Japanese Yen, and Chinese Yuan. The functional currency of our subsidiaries that either operate or support these websites is the same as the corresponding local currency. The results of operations of, and certain of our intercompany balances associated with, our internationally-focused websites are exposed to foreign exchange rate fluctuations. Upon consolidation, as exchange rates vary, net sales and other operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. For example, as a result of fluctuations in foreign exchange rates during 2012, International segment revenues decreased $853 million in comparison with the prior year.

We have foreign exchange risk related to foreign-denominated cash, cash equivalents, and marketable securities (foreign funds). Based on the balance of foreign funds at December 31, 2012 of $5.1 billion, an assumed 5%, 10%, and 20% negative currency movement would result in fair value declines of $255 million, $515 million, and $1.0 billion. All investments are classified as available for sale. Fluctuations in fair value are recorded in Accumulated other comprehensive income (loss), a separate component of stockholders equity.

We have foreign exchange risk related to our intercompany balances denominated in various foreign currencies. Based on the intercompany balances at December 31, 2012, an assumed 5%, 10%, and 20% adverse change to foreign exchange would result in losses of $10 million, $20 million, and $40 million, recorded to Other income (expense), net.

See Item 7 of Part II, Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Effect of Exchange Rates, for additional information on the effect on reported results of changes in exchange rates.

Investment Risk

As of December 31, 2012, our recorded basis in equity investments was $140 million. These investments primarily relate to equity and cost method investments in private companies. We review our investments for impairment when events and circumstances indicate that the decline in fair value of such assets below the carrying value is other-than-temporary. Our analysis includes review of recent operating results and trends, recent sales/acquisitions of the investee securities, and other publicly available data. The current global economic climate provides additional uncertainty. Valuations of private companies are inherently more difficult due to the lack of readily available market data. As such, we believe that market sensitivities are not practicable.

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Item 8. ***Financial Statements and Supplementary Data***

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Amazon.com, Inc.

We have audited the accompanying consolidated balance sheets of Amazon.com, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Amazon.com, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Amazon.com, Inc. s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 29, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Seattle, Washington

January 29, 2013

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AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	Year Ended December 31,		
	2012	**2011**	**2010**
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 5,269	$ 3,777	$ 3,444
OPERATING ACTIVITIES:			
Net income (loss)	(39)	631	1,152
Adjustments to reconcile net income (loss) to net cash from operating activities:			
Depreciation of property and equipment, including internal-use software and website development, and other amortization	2,159	1,083	568
Stock-based compensation	833	557	424
Other operating expense (income), net	154	154	106
Losses (gains) on sales of marketable securities, net	(9)	(4)	(2)
Other expense (income), net	253	(56)	(79)
Deferred income taxes	(265)	136	4
Excess tax benefits from stock-based compensation	(429)	(62)	(259)
Changes in operating assets and liabilities:			
Inventories	(999)	(1,777)	(1,019)
Accounts receivable, net and other	(861)	(866)	(295)
Accounts payable	2,070	2,997	2,373
Accrued expenses and other	1,038	1,067	740
Additions to unearned revenue	1,796	1,064	687
Amortization of previously unearned revenue	(1,521)	(1,021)	(905)
Net cash provided by (used in) operating activities	4,180	3,903	3,495
INVESTING ACTIVITIES:			
Purchases of property and equipment, including internal-use software and website development	(3,785)	(1,811)	(979)
Acquisitions, net of cash acquired, and other	(745)	(705)	(352)
Sales and maturities of marketable securities and other investments	4,237	6,843	4,250
Purchases of marketable securities and other investments	(3,302)	(6,257)	(6,279)
Net cash provided by (used in) investing activities	(3,595)	(1,930)	(3,360)
FINANCING ACTIVITIES:			
Excess tax benefits from stock-based compensation	429	62	259
Common stock repurchased	(960)	(277)	
Proceeds from long-term debt and other	3,378	177	143
Repayments of long-term debt, capital lease, and finance lease obligations	(588)	(444)	(221)
Net cash provided by (used in) financing activities	2,259	(482)	181
Foreign-currency effect on cash and cash equivalents	(29)	1	17
Net increase (decrease) in cash and cash equivalents	2,815	1,492	333
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 8,084	$ 5,269	$ 3,777
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid for interest on long-term debt	$ 31	$ 14	$ 11
Cash paid for income taxes (net of refunds)	112	33	75
Property and equipment acquired under capital leases	802	753	405
Property and equipment acquired under build-to-suit leases	29	259	172

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

	Year Ended December 31,		
	2012	**2011**	**2010**
Net product sales	$ 51,733	$ 42,000	$ 30,792
Net services sales	9,360	6,077	3,412
Total net sales	61,093	48,077	34,204
Operating expenses (1):			
Cost of sales	45,971	37,288	26,561
Fulfillment	6,419	4,576	2,898
Marketing	2,408	1,630	1,029
Technology and content	4,564	2,909	1,734
General and administrative	896	658	470
Other operating expense (income), net	159	154	106
Total operating expenses	60,417	47,215	32,798
Income from operations	676	862	1,406
Interest income	40	61	51
Interest expense	(92)	(65)	(39)
Other income (expense), net	(80)	76	79
Total non-operating income (expense)	(132)	72	91
Income before income taxes	544	934	1,497
Provision for income taxes	(428)	(291)	(352)
Equity-method investment activity, net of tax	(155)	(12)	7
Net income (loss)	$ (39)	$ 631	$ 1,152
Basic earnings per share	$ (0.09)	$ 1.39	$ 2.58
Diluted earnings per share	$ (0.09)	$ 1.37	$ 2.53
Weighted average shares used in computation of earnings per share:			
Basic	453	453	447
Diluted	453	461	456

(1) Includes stock-based compensation as follows:

Fulfillment	$ 212	$ 133	$ 90
Marketing	61	39	27

Technology and content	434	292	223
General and administrative	126	93	84

See accompanying notes to consolidated financial statements.

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

	Year Ended December 31,		
	2012	2011	2010
Net income (loss)	$ (39)	$ 631	$ 1,152
Other comprehensive income (loss):			
Foreign currency translation adjustments, net of tax of $(30), $20, and $29	76	(123)	(137)
Net change in unrealized gains on available-for-sale securities:			
Unrealized gains (losses), net of tax of $(3), $1, and $(2)	8	(1)	5
Reclassification adjustment for losses (gains) included in net income, net of tax effect of $3, $1, and $0	(7)	(2)	(2)
Net unrealized gains (losses) on available-for-sale securities	1	(3)	3
Total other comprehensive income (loss)	77	(126)	(134)
Comprehensive income	$ 38	$ 505	$ 1,018

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)

	December 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,084	$ 5,269
Marketable securities	3,364	4,307
Inventories	6,031	4,992
Accounts receivable, net and other	3,364	2,571
Deferred tax assets	453	351
Total current assets	21,296	17,490
Property and equipment, net	7,060	4,417
Deferred tax assets	123	28
Goodwill	2,552	1,955
Other assets	1,524	1,388
Total assets	$ 32,555	$ 25,278
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 13,318	$ 11,145
Accrued expenses and other	5,684	3,751
Total current liabilities	19,002	14,896
Long-term debt	3,084	255
Other long-term liabilities	2,277	2,370
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 478 and 473		
Outstanding shares 454 and 455	5	5
Treasury stock, at cost	(1,837)	(877)
Additional paid-in capital	8,347	6,990
Accumulated other comprehensive loss	(239)	(316)
Retained earnings	1,916	1,955
Total stockholders equity	8,192	7,757
Total liabilities and stockholders equity	$ 32,555	$ 25,278

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in millions)

	Common Stock						
	Shares	**Amount**	**Treasury Stock**	**Additional Paid-In Capital**	**Accumulated Other Comprehensive Income (Loss)**	**Retained Earnings**	**Total Stockholders Equity**
Balance at January 1, 2010	444	$ 5	$ (600)	$ 5,736	$ (56)	$ 172	$ 5,257
Net income						1,152	1,152
Other comprehensive income (loss)					(134)		(134)
Exercise of common stock options	7			16			16
Excess tax benefits from stock-based compensation				145			145
Stock-based compensation and issuance of employee benefit plan stock				428			428
Balance at December 31, 2010	451	5	(600)	6,325	(190)	1,324	6,864
Net income						631	631
Other comprehensive income (loss)					(126)		(126)
Exercise of common stock options	5			7			7
Repurchase of common stock	(1)		(277)				(277)
Excess tax benefits from stock-based compensation				62			62
Stock-based compensation and issuance of employee benefit plan stock				569			569
Issuance of common stock for acquisition activity				27			27
Balance at December 31, 2011	455	5	(877)	6,990	(316)	1,955	7,757
Net income (loss)						(39)	(39)
Other comprehensive income					77		77
Exercise of common stock options	4			8			8
Repurchase of common stock	(5)		(960)				(960)
Excess tax benefits from stock-based compensation				429			429
Stock-based compensation and issuance of employee benefit plan stock				854			854
Issuance of common stock for acquisition activity				66			66
Balance at December 31, 2012	454	$ 5	$ (1,837)	$ 8,347	$ (239)	$ 1,916	$ 8,192

See accompanying notes to consolidated financial statements.

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AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 DESCRIPTION OF BUSINESS AND ACCOUNTING POLICIES

Description of Business

Amazon.com opened its virtual doors on the World Wide Web in July 1995 and offers Earth s Biggest Selection. We seek to be Earth s most customer-centric company for four primary customer sets: consumers, sellers, enterprises, and content creators. We serve consumers through our retail websites and focus on selection, price, and convenience. We also manufacture and sell Kindle devices. We offer programs that enable sellers to sell their products on our websites and their own branded websites and to fulfill orders through us, and programs that allow authors, musicians, filmmakers, app developers, and others to publish and sell content. We serve developers and enterprises of all sizes through AWS, which provides access to technology infrastructure that enables virtually any type of business. In addition, we generate revenue through services, such as advertising services and co-branded credit card agreements.

We have organized our operations into two principal segments: North America and International. See Note 12 Segment Information.

Prior Period Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. Long-term debt is now presented separately on our consolidated balance sheets.

Principles of Consolidation

The consolidated financial statements include the accounts of Amazon.com, Inc., its wholly-owned subsidiaries, and those entities in which we have a variable interest and are the primary beneficiary. Intercompany balances and transactions between consolidated entities are 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, determining the selling price of products and services in multiple element revenue arrangements and determining the lives of these elements, incentive discount offers, sales returns, vendor funding, stock-based compensation, income taxes, valuation and impairment of investments, inventory valuation and inventory purchase commitments, collectability of receivables, valuation of acquired intangibles and goodwill, depreciable lives of property and equipment, internally-developed software, acquisition purchase price allocations, investments in equity interests, and contingencies. Actual results could differ materially from those estimates.

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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The following table shows the calculation of diluted shares (in millions):

	Year Ended December 31,		
	2012	**2011**	**2010**
Shares used in computation of basic earnings per share	453	453	447
Total dilutive effect of outstanding stock awards (1)		8	9
Shares used in computation of diluted earnings per share	453	461	456

(1) Calculated using the treasury stock method, which assumes proceeds are used to reduce the dilutive effect of outstanding stock awards. Assumed proceeds include the unrecognized deferred compensation of stock awards, and assumed tax proceeds from excess stock-based compensation deductions.

Cash and Cash Equivalents

We classify all highly liquid instruments with an original maturity of three months or less at the time of purchase as cash equivalents.

Inventories

Inventories, consisting of products available for sale, are primarily accounted for using the 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.

We provide Fulfillment by Amazon services in connection with certain of our sellers programs. Third-party sellers maintain ownership of their inventory, regardless of whether fulfillment is provided by us or the third-party sellers, and therefore these products are not included in our inventories.

Accounts Receivable, Net, and Other

Included in Accounts receivable, net and other on our consolidated balance sheets are amounts primarily related to vendor and customer receivables. At December 31, 2012 and 2011, vendor receivables, net, were $1.1 billion and $934 million, and customer receivables, net, were $1.5 billion and $1.2 billion.

Allowance for Doubtful Accounts

We estimate losses on receivables based on known troubled accounts and historical experience of losses incurred. Receivables are considered impaired and written-off when it is probable that all contractual payments due will not be collected in accordance with the terms of the agreement. The allowance for doubtful accounts was $116 million and $82 million at December 31, 2012 and 2011.

Internal-use Software and Website Development

Costs incurred to develop software for internal use and our websites are capitalized and amortized over the estimated useful life of the software. Costs related to design or maintenance of internal-use software and website development are expensed as incurred. For the years ended 2012, 2011, and 2010, we capitalized $454 million (including $74 million of stock-based compensation), $307 million (including $51 million of stock-based compensation), and $213 million (including $38 million of stock-based compensation) of costs associated with internal-use software and website development. Amortization of previously capitalized amounts was $327 million, $236 million, and $184 million for 2012, 2011, and 2010.

Property and Equipment, Net

Property and equipment are stated at cost. Property includes buildings and land that we own, along with property we have acquired under build-to-suit, financing, and capital lease arrangements. Equipment includes assets such as furniture and fixtures, heavy equipment, servers and networking equipment, and internal-use software and website development. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets (generally the lesser of 40 years or the remaining life of the underlying building, two years for assets such as internal-use software, three years for our servers, five years for networking equipment, five years for furniture and fixtures, and ten years for heavy equipment). Depreciation expense is classified within the corresponding operating expense categories on our consolidated statements of operations.

Leases and Asset Retirement Obligations

We categorize leases at their inception as either operating or capital leases. On certain of our lease agreements, we may receive rent holidays and other incentives. We recognize lease costs on a straight-line basis without regard to deferred payment terms, such as rent holidays that defer the commencement date of required payments. Additionally, incentives we receive are treated as a reduction of our costs over the term of the agreement. Leasehold improvements are capitalized at cost and amortized over the lesser of their expected useful life or the non-cancellable term of the lease.

We establish assets and liabilities for the estimated construction costs incurred under build-to-suit lease arrangements to the extent we are involved in the construction of structural improvements or take construction risk prior to commencement of a lease. Upon occupancy of facilities under build-to-suit leases, we assess whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance. If we continue to be the deemed owner, the facilities are accounted for as financing leases.

We establish assets and liabilities for the present value of estimated future costs to retire long-lived assets at the termination or expiration of a lease. Such assets are depreciated over the lease period into operating expense, and the recorded liabilities are accreted to the future value of the estimated retirement costs.

Goodwill

We evaluate goodwill for impairment annually or more frequently when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. We test goodwill for impairment by first comparing the book value of net assets to the fair value of the reporting units. If the fair value is determined to be less than the book value or qualitative factors indicate that it is more likely than not that goodwill is impaired, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value. We estimate the fair value of the reporting units using discounted cash flows. Forecasts of future cash flows are based on our best estimate of future net sales and operating expenses, based primarily on expected category expansion, pricing, market segment share, and general economic conditions.

We conduct our annual impairment test as of October 1 of each year, and have determined there to be no impairment for any of the periods presented. There were no triggering events identified from the date of our assessment through December 31, 2012 that would require an update to our annual impairment test. See Note 4 Acquisitions, Goodwill, and Acquired Intangible Assets.

Other Assets

Included in Other assets on our consolidated balance sheets are amounts primarily related to acquired intangible assets, net of amortization; digital video content, net of amortization; certain equity investments; marketable securities restricted for longer than one year, the majority of which are attributable to collateralization of bank guarantees and debt related to our international operations; and intellectual property rights, net of amortization.

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Investments

We generally invest our excess cash in investment grade short-to intermediate-term fixed income securities and AAA-rated money market funds. Such investments are included in "Cash and cash equivalents," or "Marketable securities" on the accompanying consolidated balance sheets, classified as available for sale, and reported at fair value with unrealized gains and losses included in "Accumulated other comprehensive loss."

Equity investments, including our 29% investment in LivingSocial, 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. The total of our investments in equity-method investees, including identifiable intangible assets, deferred tax liabilities, and goodwill, is included within "Other assets" on our consolidated balance sheets. Our share of the earnings or losses as reported by equity method investees, amortization of the related intangible assets, and related gains or losses, if any, are classified as "Equity-method investment activity, net of tax" on our consolidated statements of operations. Our share of the net income or loss of our equity method investees includes operating and non-operating gains and charges, which can have a significant impact on our reported equity-method investment activity and the carrying value of those investments. We regularly evaluate these investments, which are not carried at fair value, for other-than-temporary impairment. We also consider whether our equity method investments generate sufficient cash flows from their operating or financing activities to meet their obligations and repay their liabilities when they come due.

We record purchases, including incremental purchases, of shares in equity-method investees at cost. Reductions in our ownership percentage of an investee, including through dilution, are generally valued at fair value, with the difference between fair value and our recorded cost reflected as a gain or loss in our equity-method investment activity. In the event we no longer have the ability to exercise significant influence over an equity-method investee, we would discontinue accounting for the investment under the equity method.

Equity investments without readily determinable fair values for which we do not have the ability to exercise significant influence are accounted for using the cost method of accounting and classified as "Other assets" on our consolidated balance sheets. Under the cost method, investments are carried at cost and are adjusted only for other-than-temporary declines in fair value, certain distributions, and additional investments.

Equity investments that have readily determinable fair values are classified as available for sale and are included in "Marketable securities" in our consolidated balance sheet and are recorded at fair value with unrealized gains and losses, net of tax, included in "Accumulated other comprehensive loss."

We periodically evaluate whether declines in fair values of our investments below their book value 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 until a forecasted recovery occurs. Additionally, we assess whether we have plans to sell the security or it is more likely than not we will be required to sell any investment before recovery of its amortized cost basis. Factors considered include quoted market prices; recent financial results and operating trends; implied values from any recent transactions or offers of investee securities; credit quality of debt instrument issuers; other publicly available information that may affect the value of our investments; duration and severity of the decline in value; and our strategy and intentions for holding the investment.

Long-Lived Assets

Long-lived assets, other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Conditions that would necessitate an impairment assessment include a significant decline in the observable market value of an asset, a significant change in the extent or manner in which an asset is used, or any other significant adverse change that would indicate that the carrying amount of an asset or group of assets may not be recoverable.

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For long-lived assets used in operations, impairment losses are only recorded if the asset s carrying amount is not recoverable through its undiscounted, probability-weighted future cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value. Long-lived assets are considered held for sale when certain criteria are met, including when management has committed to a plan to sell the asset, the asset is available for sale in its immediate condition, and the sale is probable within one year of the reporting date. Assets held for sale are reported at the lower of cost or fair value less costs to sell. Assets held for sale were not significant at December 31, 2012 or 2011.

Accrued Expenses and Other

Included in Accrued expenses and other at December 31, 2012 and 2011 were liabilities of $1.1 billion and $788 million for unredeemed gift certificates. We reduce the liability for a gift certificate when redeemed by a customer. 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 the 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. Unearned revenue primarily relates to Amazon Prime memberships and AWS services. 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 $792 million and $462 million at December 31, 2012 and 2011. Non-current unearned revenue was $108 million and $87 million at December 31, 2012 and 2011.

Income Taxes

Income tax expense includes U.S. and international income taxes. Except as required under U.S. tax law, we do not provide for U.S. taxes on our undistributed earnings of foreign subsidiaries that have not been previously taxed since we intend to invest such undistributed earnings indefinitely outside of the U.S. If our intent changes or if these funds are needed for our U.S. operations, we would be required to accrue or pay U.S. taxes on some or all of these undistributed earnings. Undistributed earnings of foreign subsidiaries that are indefinitely invested outside of the U.S were $2.1 billion at December 31, 2012. Determination of the unrecognized deferred tax liability that would be incurred if such amounts were repatriated is not practicable.

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.

Deferred tax assets are 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 and capital gains by taxing jurisdiction, the carry-forward periods available to us for tax reporting purposes, and other relevant factors. We allocate our valuation allowance to current and long-term deferred tax assets on a pro-rata basis.

We utilize a two-step approach to recognizing and measuring uncertain income tax positions (tax contingencies). 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. 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 forecast actual outcomes. We include interest and penalties related to our tax contingencies in income tax expense.

Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. To increase the comparability of fair value measures, the following hierarchy prioritizes the inputs to valuation methodologies used to measure fair value:

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

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

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

We measure the fair value of money market funds and equity securities based on quoted prices in active markets for identical assets or liabilities. All other financial instruments were valued either based on recent trades of securities in inactive markets or based on quoted market prices of similar instruments and other significant inputs derived from or corroborated by observable market data. We did not hold any cash, cash equivalents, or marketable securities categorized as Level 3 as of December 31, 2012, or December 31, 2011.

Revenue

We recognize revenue from product sales or services rendered when the following four 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. Revenue arrangements with multiple deliverables are divided into separate units and revenue is allocated using estimated selling prices if we do not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables. We allocate the arrangement price to each of the elements based on the estimated selling prices of each element. Estimated selling prices are management s best estimates of the prices that we would charge our customers if we were to sell the standalone elements separately and include considerations of customer demand, prices charged by us and others for similar deliverables, and the price if largely based on costs. Sales of our Kindle device are considered arrangements with multiple deliverables, consisting of the device, 3G wireless access and delivery for some models, and software upgrades. The revenue related to the device, which is the substantial portion of the total sale price, and related costs are recognized upon delivery. Revenue related to 3G wireless access and delivery and software upgrades is amortized over the average life of the device, which is estimated to be three years.

We evaluate 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 primarily 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 at the gross sales price. We generally record the net amounts as commissions earned if we are not primarily obligated and do not have latitude in establishing prices. Such amounts earned are determined using a fixed percentage, a fixed-payment schedule, or a combination of the two.

Product sales represent revenue from the sale of products and related shipping fees and digital content where we are the seller of record. 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. Kindle devices sold through retailers are recognized at the point of sale to consumers. Retail sales to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss upon our delivery to the carrier.

Services sales represent third-party seller fees earned (including commissions) and related shipping fees, and non-retail activities such as AWS, advertising services, and our co-branded credit card agreements. Services sales, net of promotional discounts and return allowances, are recognized when services have been rendered. Amounts received in advance for services, including amounts received for Amazon Prime and web services, are deferred and recognized as revenue over the term.

Return allowances, which reduce revenue, are estimated using historical experience. Revenue from product sales and services rendered is recorded net of sales and consumption taxes. Additionally, 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 presented as a net amount in Total net sales.

Cost of Sales

Cost of sales consists of the purchase price of consumer products and digital content where we are the seller of record, inbound and outbound shipping charges, and packaging supplies. Shipping charges to receive products from our suppliers are included in our inventory, and recognized as cost of sales upon sale of products to our customers. Payment processing and related transaction costs, including those associated with seller transactions, are classified in Fulfillment on our consolidated statements of operations.

Content Costs

We obtain digital video content through licensing agreements that have a wide range of licensing provisions and are generally from one to five years with fixed payment schedules. When the license fee for a specific movie or television title is determinable or reasonably estimable and available for streaming, we recognize an asset representing the fee per title and a corresponding liability for the amounts owed. We amortize the asset on a straight-line basis over each title s contractual window of availability, which typically ranges from six months to five years. If we are unable to reasonably estimate the cost per title, no asset or liability is recorded and licensing costs are expensed as incurred.

Vendor Agreements

We have agreements to receive cash consideration from certain of our vendors, including rebates and cooperative marketing reimbursements. We generally consider amounts received from our vendors as a reduction of the prices we pay for their products and, therefore, record such amounts as a reduction of the cost of inventory we buy from them. Vendor rebates are typically dependent upon reaching minimum purchase thresholds. We evaluate the likelihood of reaching purchase thresholds using past experience and current year forecasts. When volume rebates can be reasonably estimated, we record a portion of the rebate as we make progress towards the purchase threshold.

When we receive direct reimbursements for costs incurred by us in advertising the vendor s product or service, the amount we receive is recorded as an offset to Marketing on our consolidated statements of operations.

Fulfillment

Fulfillment costs represent those costs incurred in operating and staffing our fulfillment and customer service centers, including costs attributable to buying, receiving, inspecting, and warehousing inventories;

picking, packaging, and preparing customer orders for shipment; payment processing and related transaction costs, including costs associated with our guarantee for certain seller transactions; responding to inquiries from customers, and supply chain management for our manufactured Kindle devices. Fulfillment costs also include amounts paid to third parties that assist us in fulfillment and customer service operations.

Marketing

Marketing costs consist primarily of targeted online advertising, television advertising, public relations expenditures; and payroll and related expenses for personnel engaged in marketing, business development, and selling activities. We pay commissions to participants in our Associates program when their customer referrals result in product sales and classify such costs as Marketing on our consolidated statements of operations. We also participate in cooperative advertising arrangements with certain of our vendors, and other third parties.

Advertising and other promotional costs are expensed as incurred and were $2.0 billion, $1.4 billion, and $890 million in 2012, 2011, and 2010. Prepaid advertising costs were not significant at December 31, 2012 and 2011.

Technology and Content

Technology and content expenses consist principally of technology infrastructure expenses and payroll and related expenses for employees involved in application, product, and platform development, category expansion, editorial content, buying, merchandising selection, systems support, and digital initiatives, as well as costs associated with the compute, storage, and telecommunications infrastructure used internally and supporting AWS.

Technology and content costs are expensed as incurred, except for certain costs relating to the development of internal-use software and website development, including software used to upgrade and enhance our websites and applications supporting our business, which are capitalized and amortized over two years.

General and Administrative

General and administrative expenses consist of payroll and related expenses for employees involved in general corporate functions, including accounting, finance, tax, legal, and human relations, among others; costs associated with use by these functions of facilities and equipment, such as depreciation expense and rent; professional fees and litigation costs; and other general corporate costs.

Stock-Based Compensation

Compensation cost for all stock-based awards expected to vest is measured at fair value on the date of grant and recognized over the service period. The fair value of restricted stock units is determined based on the number of shares granted and the quoted price of our common stock. Such value is recognized as expense over the service period, net of estimated forfeitures, using the accelerated method. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including employee class, economic environment, and historical experience.

Other Operating Expense (Income), Net

Other operating expense (income), net, consists primarily of intangible asset amortization expense and expenses related to legal settlements.

Other Income (Expense), Net

Other income (expense), net, consists primarily of foreign currency gains and losses of $(95) million, $64 million, and $75 million in 2012, 2011, and 2010, and realized gains and losses on marketable securities sales of $10 million, $4 million, and $1 million in 2012, 2011, and 2010.

Foreign Currency

We have internationally-focused websites for the United Kingdom, Germany, France, Japan, Canada, China, Italy, Spain, and Brazil. Net sales generated from these websites, as well as most of the related expenses directly incurred from those operations, are denominated in the functional currencies of the resident countries. The functional currency of our subsidiaries that either operate or support these websites is the same as the local currency. Assets and liabilities of these subsidiaries are translated into U.S. Dollars at period-end exchange rates, and revenues and expenses are translated at average rates prevailing throughout the period. Translation adjustments are included in Accumulated other comprehensive income (loss), a separate component of stockholders equity, and in the Foreign-currency effect on cash and cash equivalents, on our consolidated statements of cash flows. Transaction gains and losses including intercompany transactions denominated in a currency other than the functional currency of the entity involved are included in Other income (expense), net on our consolidated statements of operations. In connection with the settlement and remeasurement of intercompany balances, we recorded gains (losses) of $(95) million in 2012 and $70 million in both 2011 and 2010.

Recent Accounting Pronouncements

In 2011, the Financial Accounting Standards Board (FASB) issued two Accounting Standard Updates (ASU), which amend guidance for the presentation of comprehensive income. The amended guidance requires an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. The option to report other comprehensive income and its components in the statement of stockholders equity has been eliminated. Although the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under existing guidance. We adopted these ASUs using two consecutive statements for all periods presented.

Note 2 CASH, CASH EQUIVALENTS, AND MARKETABLE SECURITIES

As of December 31, 2012 and 2011, our cash, cash equivalents, and marketable securities primarily consisted of cash, U.S. and foreign government and agency securities, AAA-rated money market funds, and other investment grade securities. Our marketable fixed-income securities have effective maturities of less than 5 years. Cash equivalents and marketable securities are recorded at fair value. The following table summarizes,

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

	December 31, 2012			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Estimated Fair Value
Cash	$ 2,595			$ 2,595
Level 1 securities:				
Money market funds	5,561			5,561
Equity securities	2			2
Level 2 securities:				
Foreign government and agency securities	763	9		772
U.S. government and agency securities	1,809	3	(2)	1,810
Corporate debt securities	719	6		725
Asset-backed securities	49			49
Other fixed income securities	33			33
	$ 11,531	$ 18	$ (2)	$ 11,547
Less: Restricted cash, cash equivalents, and marketable securities (1)				(99)
Total cash, cash equivalents, and marketable securities				$ 11,448

	December 31, 2011			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Estimated Fair Value
Cash	$ 1,207			$ 1,207
Level 1 securities:				
Money market funds	3,651			3,651
Equity securities	2		(1)	1
Level 2 securities:				
Foreign government and agency securities	1,627	14	(1)	1,640
U.S. government and agency securities	2,592	3	(2)	2,593
Corporate debt securities	562	3	(2)	563
Asset-backed securities	56		(1)	55
Other fixed income securities	22			22
	$ 9,719	$ 20	$ (7)	$ 9,732
Less: Restricted cash, cash equivalents, and marketable securities (1)				(156)
Total cash, cash equivalents, and marketable securities				$ 9,576

(1)

We are required to pledge or otherwise restrict a portion of our cash, cash equivalents, and marketable securities as collateral for standby and trade letters of credit, guarantees, debt, and real estate lease agreements. We classify cash and marketable securities with use restrictions of less than twelve months as Accounts receivable, net and other and of twelve months or longer as non-current Other assets on our consolidated balance sheets. See Note 8 Commitments and Contingencies.

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The following table summarizes gross gains and gross losses realized on sales of available-for-sale marketable securities (in millions):

	Year Ended December 31,		
	2012	2011	2010
Realized gains	$ 20	$ 15	$ 5
Realized losses	10	11	4

The following table summarizes the maturities of our cash equivalent and marketable fixed-income securities as of December 31, 2012 (in millions):

	Amortized Cost	Estimated Fair Value
Due within one year	$ 6,689	$ 6,691
Due after one year through five years	1,968	1,981
Due after five years	277	278
	$ 8,934	$ 8,950

Actual maturities may differ from the contractual maturities because borrowers may have certain prepayment conditions.

Note 3 PROPERTY AND EQUIPMENT

Property and equipment, at cost, consisted of the following (in millions):

	December 31,	
	2012	2011
Gross Property and Equipment (1):		
Land and buildings	$ 2,966	$ 1,437
Equipment and internal-use software (2)	6,228	4,106
Other corporate assets	174	137
Construction in progress	214	106
Gross property and equipment	$ 9,582	$ 5,786
Total accumulated depreciation (1)	2,522	1,369
Total property and equipment, net	$ 7,060	$ 4,417

(1) Excludes the original cost and accumulated depreciation of fully-depreciated assets.
(2) Includes internal-use software of $866 million and $623 million at December 31, 2012 and 2011.

In December 2012, we acquired our corporate headquarters for $1.2 billion consisting of land and 11 buildings that were previously accounted for as financing leases. The acquired building assets will be depreciated over their estimated useful lives of 40 years. We also acquired three city blocks of land for the expansion of our corporate headquarters for approximately $210 million.

Depreciation expense on property and equipment was $1.7 billion, $1.0 billion, and $552 million, which includes amortization of property and equipment acquired under capital lease obligations of $510 million, $335 million, and $164 million for 2012, 2011, and 2010. Gross assets remaining under capital leases were $2.3 billion and $1.6 billion at December 31, 2012 and 2011. Accumulated depreciation associated with

capital leases was $1.1 billion and $603 million at December 31, 2012 and 2011. Cash paid for interest on capital leases was $51 million, $44 million, and $26 million for 2012, 2011, and 2010.

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Note 4 ACQUISITIONS, GOODWILL, AND ACQUIRED INTANGIBLE ASSETS

2012 Acquisition Activity

In May 2012, we acquired Kiva Systems, Inc. (Kiva) for a purchase price of $678 million. The primary reason for this acquisition was to improve fulfillment center productivity. Acquisition-related costs were expensed as incurred and were not significant. The aggregate purchase price of this acquisition was allocated as follows (in millions):

Purchase Price	
Cash paid, net of cash acquired	$ 613
Stock options assumed	65
	$ 678
Allocation	
Goodwill	$ 560
Intangible assets (1):	
Marketing-related	5
Contract-based	3
Technology-based	168
Customer-related	17
	193
Property and equipment	9
Deferred tax assets	34
Other assets acquired	41
Deferred tax liabilities	(81)
Other liabilities assumed	(78)
	$ 678

(1) Acquired intangible assets have estimated useful lives of between four and 10 years, with a weighted-average amortization period of five years.

The fair value of assumed stock options was estimated using the Black-Scholes model. We determined the estimated fair value of identifiable intangible assets acquired primarily by using the income and cost approaches. These assets are included within Other assets on our consolidated balance sheets and are being amortized to operating expenses on a straight-line or accelerated basis over their estimated useful lives.

Pro Forma Financial Information 2012 Acquisition Activity (unaudited)

Kiva was consolidated into our financial statements starting on its acquisition date. The net sales and operating loss of Kiva recorded in our consolidated statement of operations from its acquisition date through December 31, 2012, were $61 million and $(62) million. The following pro forma financial information presents our results as if the Kiva acquisition had occurred at the beginning of 2011 (in millions):

	Year Ended December 31,	
	2012	**2011**
Net sales	$ 61,118	$ 48,157
Net income (loss)	(2)	499

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2011 Acquisition Activity

In 2011, we acquired certain companies for an aggregate purchase price of $771 million. The primary reasons for these acquisitions, none of which was individually material to our consolidated financial statements, were to expand our customer base and sales channels, including our consumer channels and subscription entertainment services. Acquisition-related costs were expensed as incurred and were not significant. The aggregate purchase price of these acquisitions was allocated as follows (in millions):

Purchase Price	
Cash paid, net of cash acquired	$ 637
Existing equity interest	89
Indemnification holdbacks	25
Stock options assumed	20
	$ 771
Allocation	
Goodwill	$ 615
Intangible assets (1):	
Marketing-related	130
Customer-related	94
Contract-based	6
	230
Property and equipment	119
Deferred tax assets	49
Other assets acquired	68
Accounts payable	(65)
Debt	(70)
Deferred tax liabilities	(75)
Other liabilities assumed (2)	(100)
	$ 771

(1) Amortization periods range from two to 10 years, with a weighted-average amortization period of eight years.
(2) Includes a $38 million contingent liability related to historic tax exposures.

In addition to cash consideration and the fair value of vested stock options, the aggregate purchase price included the estimated fair value of our previous, noncontrolling interest in one of the acquired companies. We remeasured this equity interest to fair value at the acquisition date and recognized a non-cash gain of $6 million in Equity-method investment activity, net of tax, in our 2011 consolidated statement of operations. The fair value of assumed stock options was estimated using the Black-Scholes model. We determined the estimated fair value of identifiable intangible assets acquired primarily by using the income and cost approaches. Purchased identifiable intangible assets are included within Other assets on our consolidated balance sheets and are being amortized to operating expenses on a straight-line or accelerated basis over their estimated useful lives.

Pro forma results of operations have not been presented because the effects of these acquisitions, individually and in the aggregate, were not material to our consolidated results of operations.

2010 Acquisition Activity

In 2010, we acquired certain companies for an aggregate purchase price of $228 million, resulting in goodwill of $111 million and acquired intangible assets of $91 million. The primary reasons for these acquisitions were to expand our customer base and sales channels. The purchase price was allocated to the

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tangible assets and intangible assets acquired and liabilities assumed based on their estimated fair values on the acquisition date, with the remaining unallocated purchase price recorded as goodwill. The fair value assigned to identifiable intangible assets acquired was determined primarily by using the income and cost approaches. These intangible assets are being amortized on a straight-line or accelerated basis over their respective useful lives.

Pro forma results of operations have not been presented because the effects of these acquisitions, individually and in the aggregate, were not material to our consolidated results of operations.

Goodwill

The goodwill of the acquired companies is generally not deductible for tax purposes and is primarily related to expected improvements in fulfillment center productivity and sales growth from future product offerings and customers, together with certain intangible assets that do not qualify for separate recognition.

The following summarizes our goodwill activity in 2012 and 2011 by segment (in millions):

	North America	International	Consolidated
Goodwill - January 1, 2011	$ 1,116	$ 233	$ 1,349
New acquisitions	417	198	615
Other adjustments (1)		(9)	(9)
Goodwill - December 31, 2011	1,533	422	1,955
New acquisitions (2)	403	184	587
Other adjustments (1)	1	9	10
Goodwill - December 31, 2012	$ 1,937	$ 615	$ 2,552

(1) Primarily includes changes in foreign exchange.
(2) Primarily includes the goodwill of Kiva.

Intangible Assets

Acquired intangible assets, included within "Other assets" on our consolidated balance sheets, consist of the following (in millions):

	December 31,						
	2012				2011		
	Weighted Average Life Remaining	Acquired Intangibles, Gross (1)	Accumulated Amortization (1)	Acquired Intangibles, Net	Acquired Intangibles, Gross (1)	Accumulated Amortization (1)	Acquired Intangibles, Net
Marketing-related	7.3	$ 422	$ (113)	$ 309	$ 408	$ (74)	$ 334
Contract-based	3.9	177	(89)	88	189	(74)	115
Technology- and content-based	4.9	231	(30)	201	37	(13)	24
Customer-related	3.2	332	(205)	127	343	(169)	174
Acquired intangibles (2)	5.1	$ 1,162	$ (437)	$ 725	$ 977	$ (330)	$ 647

(1) Excludes the original cost and accumulated amortization of fully-amortized intangibles.
(2) Intangible assets have estimated useful lives of between one and 10 years.

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Amortization expense for acquired intangibles was $163 million, $149 million, and $105 million in 2012, 2011, and 2010. Expected future amortization expense of acquired intangible assets as of December 31, 2012 is as follows (in millions):

Year Ended December 31,	
2013	$ 159
2014	143
2015	126
2016	103
2017	82
Thereafter	112
	$ 725

Note 5 EQUITY-METHOD INVESTMENTS

Our equity-method investments include a 29% interest in LivingSocial. Summarized condensed financial information for this investee, as provided to us by LivingSocial, is as follows (in millions):

	Year Ended December 31,	
	2012	**2011**
Statement of Operations:		
Revenue	$ 536	$ 250
Operating expense	862	669
Impairment charge	579	
Operating loss	(905)	(419)
Net loss (1)	$ (650)	$ (499)

(1) The difference between the operating loss and net loss for 2012 is primarily due to the recognition of non-operating, non-cash gains on previously held equity positions in companies that LivingSocial acquired during Q1 2012.

	December 31,	
	2012	**2011**
Balance Sheet:		
Current assets	$ 76	$ 176
Noncurrent assets	218	271
Current liabilities	338	210
Noncurrent liabilities	14	32
Mandatorily redeemable stock	205	201

LivingSocial tested its goodwill and certain long-lived assets for impairment based on certain triggering events. Although its goodwill impairment test is not complete as of the date of this filing, LivingSocial believes an impairment loss is probable and has provided to us its best estimate. Completion of this impairment test by LivingSocial may result in an adjustment to this estimate.

As of December 31, 2012, the book value of our LivingSocial investment was $52 million. The summarized financial information is included for the periods in which we held an equity method ownership interest.

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Note 6 LONG-TERM DEBT

In November 2012, we issued $3.0 billion of unsecured senior notes in three tranches as described in the table below (collectively, the Notes). The net carrying amount of the Notes was $3.0 billion and the unamortized discount was $27 million at December 31, 2012. We also have other long-term debt with a carrying amount, including the current portion, of $691 million and $384 million at December 31, 2012 and 2011. The face value of our total long-term debt obligations is as follows (in millions):

	December 31,	
	2012	**2011**
0.65% Notes due on November 27, 2015	$ 750	$
1.20% Notes due on November 29, 2017	1,000	
2.50% Notes due on November 29, 2022	1,250	
Other long-term debt	691	384
Total debt	3,691	384
Less current portion of long-term debt	(579)	(129)
Face value of long-term debt	$ 3,112	$ 255

The effective interest rates of the 2015, 2017, and 2022 Notes were 0.84%, 1.38%, and 2.66%. Interest on the Notes is payable semi-annually in arrears in May and November. We may redeem the Notes at any time in whole, or from time to time, in part at specified redemption prices. We are not subject to any financial covenants under the Notes. We used the net proceeds from the issuance of the Notes for general corporate purposes. The estimated fair value of the Notes was approximately $3.0 billion at December 31, 2012, which is based on quoted prices for our publicly-traded debt as of that date.

The other debt, including the current portion, had a weighted average interest rate of 6.4% and 5.9% in 2012 and 2011. We used the net proceeds from the issuance of the debt to fund certain international operations. The estimated fair value of the other long-term debt, which is based on Level 2 inputs, approximated its carrying value at December 31, 2012 and December 31, 2011.

At December 31, 2012, future principal payments for debt were as follows (in millions):

Year Ended December 31,	
2013	$ 579
2014	46
2015	816
2016	
2017	1,000
Thereafter	1,250
	$ 3,691

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Note 7 OTHER LONG-TERM LIABILITIES

Our other long-term liabilities are summarized as follows (in millions):

	December 31,	
	2012	2011
Long-term capital lease obligations	$ 737	$ 598
Long-term financing lease obligations (1)	9	562
Construction liabilities	87	59
Tax contingencies	336	266
Other (2)	1,108	885
	$ 2,277	$ 2,370

(1) Long-term financing lease obligations related to our corporate headquarters leases are no longer included as we acquired the associated land and buildings in December 2012. See Note 3 Property and Equipment.

(2) Primarily includes long-term deferred tax liabilities.

Capital Leases

Certain of our equipment, primarily related to technology infrastructure, and buildings have been acquired under capital leases. Long-term capital lease obligations are as follows (in millions):

	December 31, 2012
Gross capital lease obligations	$ 1,342
Less imputed interest	(50)
Present value of net minimum lease payments	1,292
Less current portion of capital lease obligation	(555)
Total long-term capital lease obligations	$ 737

Construction Liabilities

We capitalize construction in progress and record a corresponding long-term liability for build-to-suit lease agreements where we are considered the owner during the construction period for accounting purposes.

Tax Contingencies

We have recorded tax reserves for tax contingencies, inclusive of accrued interest and penalties, of approximately $336 million as of December 31, 2012, and $266 million as of December 31, 2011, for U.S. and foreign income taxes. These contingencies primarily relate to transfer pricing, state income taxes, and research and development credits. See Note 11 Income Taxes for discussion of tax contingencies.

The remainder of our long-term liabilities primarily includes deferred tax liabilities, unearned revenue, asset retirement obligations, and deferred rental liabilities.

Note 8 COMMITMENTS AND CONTINGENCIES

Commitments

We have entered into non-cancellable operating, capital, and financing leases for equipment and office, fulfillment center, and data center facilities. Rental expense under operating lease agreements was $541 million, $362 million, and $225 million for 2012, 2011, and 2010.

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The following summarizes our principal contractual commitments, excluding open orders for purchases that support normal operations, as of December 31, 2012 (in millions):

	Year Ended December 31,						
	2013	**2014**	**2015**	**2016**	**2017**	**Thereafter**	**Total**
Operating and capital commitments:							
Debt principal and interest	$ 656	$ 105	$ 866	$ 43	$ 1,069	$ 1,380	$ 4,119
Capital leases, including interest	562	403	214	51	17	95	1,342
Financing lease obligations, including interest	1	1	1	1	1	9	14
Operating leases	595	634	570	514	453	2,688	5,454
Unconditional purchase obligations (1)	302	239	143	38	1		723
Other commitments (2) (3)	380	276	253	110	78	436	1,533
Total commitments	$ 2,496	$ 1,658	$ 2,047	$ 757	$ 1,619	$ 4,608	$ 13,185

(1) Includes unconditional purchase obligations related to agreements to acquire and license digital video content that represent long-term liabilities or that are not reflected on the consolidated balance sheets.
(2) Includes the estimated timing and amounts of payments for rent and tenant improvements associated with build-to-suit lease arrangements that have not been placed in service.
(3) Excludes $294 million of tax contingencies for which we cannot make a reasonably reliable estimate of the amount and period of payment, if any.

Pledged Securities

We have pledged or otherwise restricted $99 million and $156 million in 2012 and 2011 of our cash and marketable securities as collateral for standby and trade letters of credit, guarantees, debt related to our international operations, as well as real estate leases.

Inventory Suppliers

During 2012, no vendor accounted for 10% or more of our inventory purchases. We generally do not have long-term contracts or arrangements with our vendors to guarantee the availability of merchandise, particular payment terms, or the extension of credit limits.

Legal Proceedings

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

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. The Hurst case was dismissed with prejudice in June 2012. All of the complaints seek injunctive relief, unpaid taxes, interest, attorneys fees, civil penalties of up 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.

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In November 2007, an Austrian copyright collection society, Austro-Mechana, filed lawsuits against several Amazon.com EU subsidiaries in the Commercial Court of Vienna, Austria and in the District Court of Munich, Germany seeking to collect a tariff on blank digital media sold by our EU-based retail websites to customers located in Austria. In July 2008, the German court stayed the German case pending a final decision in the Austrian case. In July 2010, the Austrian court ruled in favor of Austro-Mechana and ordered us to report all sales of products to which the tariff potentially applies for a determination of damages. We contested Austro-Mechana s claim and in September 2010 commenced an appeal in the Commercial Court of Vienna. We lost this appeal and in March 2011 commenced an appeal in the Supreme Court of Austria. In October 2011, the Austrian Supreme Court referred the case to the European Court of Justice.

In April 2009, Parallel Networks, LLC filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleged, among other things, that our website technology infringed a patent owned by Parallel Networks purporting to cover a Method And Apparatus For Client-Server Communication Using a Limited Capability Client Over A Low-Speed Communications Link (U.S. Patent No. 6,446,111) and sought injunctive relief, monetary damages, costs and attorneys fees. The complaint was dismissed without prejudice in February 2010, but the plaintiff filed a new complaint against us the following month containing similar allegations. In December 2011, the court granted Amazon s motion for summary judgment and dismissed the claims against Amazon with prejudice. In January 2013, the United States Court of Appeals for the Federal Circuit affirmed the judgment of the district court.

In May 2009, Big Baboon, Inc. filed a complaint against us for patent infringement in the United States District Court for the Central District of California. The complaint alleges, among other things, that our third-party selling and payments technology infringes a patent owned by Big Baboon, Inc. purporting to cover an Integrated Business-to-Business Web Commerce and Business Automation System (U.S. Patent No. 6,115,690) and seeks injunctive relief, monetary damages, treble damages, costs and attorneys fees. In February 2011, the Court entered an order staying the lawsuit pending the outcome of the Patent and Trademark Office s re-examination of the patent in suit. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In September 2009, SpeedTrack, Inc. filed a complaint against us for patent infringement in the United States District Court for the Northern District of California. The complaint alleges, among other things, that our website technology infringes a patent owned by SpeedTrack purporting to cover a Method For Accessing Computer Files and Data, Using Linked Categories Assigned to Each Data File Record on Entry of the Data File Record (U.S. Patent Nos. 5,544,360) and seeks injunctive relief, monetary damages, enhanced damages, costs and attorneys fees. In November 2009, the Court entered an order staying the lawsuit pending the outcome of the Patent and Trademark Office s re-examination of the patent in suit and the resolution of similar litigation against another party. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In October 2009, Eolas Technologies Incorporated filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that our website technology infringes two patents owned by Eolas purporting to cover Distributed Hypermedia Method for Automatically Invoking External Application Providing Interaction and Display of Embedded Objects within a Hypermedia Document (U.S. Patent No. 5,838,906) and Distributed Hypermedia Method and System for Automatically Invoking External Application Providing Interaction and Display of Embedded Objects within a Hypermedia Document (U.S. Patent No. 7,599,985) and seeks injunctive relief, monetary damages, costs and attorneys fees. In February 2012, the Court held a jury trial to determine the validity of the asserted patent claims, and the jury found all asserted claims invalid. In August 2012, the plaintiff filed a notice of appeal. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In December 2009, Nazomi Communications, Inc. filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that

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the processor core in our Kindle e-reader infringes two patents owned by Nazomi purporting to cover Java virtual machine hardware for RISC and CISC processors and Java hardware accelerator using microcode engine (U.S. Patent Nos. 7,080,362 and 7,225,436) and seeks monetary damages, injunctive relief, costs and attorneys fees. In October 2010, the case was transferred to the United States District Court for the Northern District of California. In January 2012, Nazomi added Amazon to a second lawsuit, which alleges, among other things, that the Kindle Fire infringes a patent owned by Nazomi purporting to cover a Constant Pool Reference Resolution Method (U.S. Patent No. 6,338,160) also seeking monetary damages, injunctive relief, costs and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In July 2010, Positive Technologies Inc. filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that certain of our products, including our Kindle e-reader, infringe three patents owned by the plaintiff purporting to cover a DC Integrating Display Driver Employing Pixel Status Memories (U.S. Patent Nos. 5,444,457; 5,627,558 and 5,831,588) and seeks monetary damages, injunctive relief, costs and attorneys fees. In April 2011, the case was transferred to the United States District Court for the Northern District of California. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In July 2010, the Federal Trade Commission (FTC) staff informed us that it was considering whether to recommend enforcement proceedings against us for advertising and selling certain textile fiber products as bamboo when they are made of rayon manufactured from bamboo, in violation of the Textile Fiber Product Identification Act, the FTC Act, and the regulations promulgated thereunder. We do not believe we violated these laws and regulations and cooperated voluntarily with the Commission s inquiry. In September 2011, we learned that the Commission voted to refer the matter to the Department of Justice for enforcement proceedings. In January 2013, we entered into a settlement of the inquiry that included, among other things, payment of a civil penalty. The payment was not material to either the current or future years.

In September 2010, Olympic Developments AG, LLC filed a complaint against us for patent infringement in the United States District Court for the Central District of California. The complaint alleges, among other things, that certain aspects of our technology, including our Kindle e-reader, infringe two patents owned by the plaintiff purporting to cover a Transactional Processing System (U.S. Patent No. 5,475,585) and a Device for Controlling Remote Interactive Receiver (U.S. Patent No. 6,246,400B1) and seeks monetary damages, injunctive relief, costs and attorneys fees. In February 2011, the case was transferred to the United States District Court for the Western District of Washington. In September 2011, 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. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In November 2010, Kelora Systems, LLC filed a complaint against us for patent infringement in the United States District Court for the Western District of Wisconsin. The complaint alleged that our website infringes a patent owned by Kelora Systems purporting to cover a Method and system for executing a guided parametric search (U.S. Patent No. 6,275,821) and sought monetary damages, costs, attorneys fees, and injunctive relief. In March 2011, the case was transferred to the United States District Court for the Northern District of California. In August 2011, Kelora filed an amended complaint adding Amazon subsidiaries Audible and Zappos as defendants. In May 2012, the lawsuit was dismissed on summary judgment. In June 2012, Kelora appealed to the United States Court of Appeals for the Federal Circuit. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In December 2010, Technology Innovations, LLC filed a complaint against us for patent infringement in the United States District Court for the Southern District of Texas. The complaint alleges, among other things, that Amazon s sale of e-books and Kindle e-readers infringes a patent owned by the plaintiff purporting to cover a Device For Including Enhancing Information With Printed Information And Method For Electronic Searching Thereof (U.S. Patent No. 5,517,407) and seeks monetary damages, injunctive relief, costs, interest, and

attorneys fees. The complaint was dismissed without prejudice in August 2011, but the plaintiff filed a new complaint against us in the United States District Court for the District of Delaware containing similar allegations and alleging infringement of an additional patent purporting to cover an Apparatus for the Display of Embedded Information (U.S. Patent No. 7,429,965). We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In January 2011, Rovi Corporation, Rovi Guides, Inc., United Video Properties, Inc., TV Guide Online, LLC, and TV Guide Online, Inc. filed a complaint against Amazon.com, Inc. and IMDb.com, Inc. in the United States District Court for the District of Delaware. The plaintiffs allege, among other things, that the use of links on instant video web pages to DVD and Blu-ray discs; instant video preview, TV season, and season pass options; IMDb TV listings (localized listings); and links on IMDb title pages to DVD and Blue-ray pages on Amazon s website infringe one or more of U.S. Patent No. 5,988,078, entitled Method and Apparatus for Receiving Customized Television Programming Information by Transmitting Geographic Location to a Service Provider Through a Wide-Area Network ; U.S. Patent No. 6,275,268, entitled Electronic Television Program Guide with Remote Product Ordering ; U.S. Patent No. 6,769,128, entitled Electronic Television Program Guide Schedule System and Method with Data Feed Access ; U.S. Patent No. 7,493,643, entitled Program Guide System with Video-On-Demand Browsing ; and U.S. Patent No. 7,603,690, entitled Interactive Television Program Guide System with Pay Program Package Promotion. The complaint seeks an unspecified amount of damages, enhanced damages, interest, attorneys fees, and an injunction. In August 2012, the court granted a stipulated judgment of non-infringement for U.S. Patent No. 6,769,128. In November 2012, Rovi s damages expert opined that, if we are found to infringe the patents-in-suit and the patents are found to be valid (both of which we dispute), Amazon and its affiliates should pay damages of approximately $40 million, subject to enhancement. In December 2012, the court dismissed with prejudice plaintiffs claims for infringement of U.S. Patent Nos. 5,988,078 and 7,493,643. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In February 2011, SFA Systems, LLC, filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that by using computer-implemented systems and methods for personalization Amazon and Zappos infringe a patent owned by the plaintiff purporting to cover an Integrated Computerized Sales Force Automation System (U.S. Patent No. 6,067,525), and seeks monetary damages, interest, costs, and attorneys fees. In August 2011, the plaintiff filed an additional complaint against us in the United States District Court for the Eastern District of Texas alleging, among other things, that certain supply chain, sales, marketing, and inventory systems and methods used by Amazon and Zappos infringe a patent owned by the plaintiff purporting to cover a Sales Force Automation System and Method (U.S. Patent No. 7,941,341), and seeking monetary damages, interest, costs, and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In April 2011, Walker Digital LLC filed several complaints against us for patent infringement in the United States District Court for the District of Delaware. The complaints allege that we infringe several of the plaintiff s U.S. patents by, among other things, providing cross benefits to customers through our promotions, (U.S. Patent Nos. 7,831,470 and 7,827,056), using a customer s identified original product to offer a substitute product (U.S. Patent No. 7,236,942), using our product recommendations and personalization features to offer complementary products together (U.S. Patent Nos. 6,601,036 and 6,138,105), enabling customers to subscribe to a delivery schedule for products they routinely use at reduced prices (U.S. Patent No. 5,970,470), and offering personalized advertising based on customers preferences identified using a data pattern (U.S. Patent No. 7,933,893). Another complaint, filed in the same court in October 2011, alleges that we infringe plaintiff s U.S. Patent No. 8,041,711 by offering personalized advertising based on customer preferences that associate data with resource locators. Another complaint, filed in the same court in February 2012, alleges that we infringe plaintiff s U.S. Patent No. 8,112,359 by using product information received from customers to identify and offer substitute products using a manufacturer database. The complaints seek monetary damages, interest, injunctive relief, costs, and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in these matters.

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In July 2011, GPNE Corp. filed a complaint against us for patent infringement in the United States District Court for the District of Hawaii. The complaint alleges, among other things, that certain aspects of our technology, including our Kindle e-reader, infringe three patents owned by the plaintiff purporting to cover a Network Communication System Wherein a Node Obtains Resources for Transmitting Data by Transmitting Two Reservation Requests (U.S. Patent No. 7,555,267), a Communication System Wherein a Clocking Signal from a Controller, a Request from a Node, Acknowledgement of the Request, and Data Transferred from the Node are all Provided on Different Frequencies, Enabling Simultaneous Transmission of these Signals (U.S. Patent No. 7,570,954) and a Network Communication System with an Alignment Signal to Allow a Controller to Provide Messages to Nodes and Transmission of the Messages over Four Independent Frequencies (U.S. Patent No. 7,792,492) and seeks monetary damages, interest, costs, and attorneys fees. In June 2012, the case was transferred to the United States District Court for the Northern District of California. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In September 2011, Parallel Iron, LLC, filed a complaint against us for patent infringement in the United States District Court for the District of Delaware. The complaint alleged, among other things, that certain AWS file storage systems that include a Hadoop Distributed File System infringe a patent owned by the plaintiff purporting to cover Methods and Systems for a Storage System With a Program-Controlled Switch for Routing Data (U.S. Patent No. 7,415,565), and sought monetary damages, injunctive relief, costs, and attorneys fees. In June 2012, the complaint was dismissed with prejudice. Later in June 2012, the plaintiff filed a new complaint in the United States District Court for the District of Delaware alleging that the same AWS file storage systems infringe three additional patents, all entitled Methods and Systems for a Storage System (U.S. Patent Nos. 7,197,662; 7,958,388; and 7,543,177), and seeking monetary damages, injunctive relief, costs, and attorneys fees. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In September 2011, Droplets, Inc. filed a complaint against us for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleged, among other things, that by offering web applications and software Amazon infringed two patents owned by the plaintiff purporting to cover a System and Method for Delivering a Graphical User Interface of Remote Applications Over a Thin Bandwidth Connection (U.S. Patent No. 6,687,745) and a System and Method for Delivering Remotely Stored Applications and Information (U.S. Patent No. 7,502,838), and sought monetary damages, injunctive relief, costs, and attorneys fees. In June 2012, the case was transferred to the United States District Court for the Northern District of California. In December 2012, we entered into a settlement of the litigation that included, among other things, a payment to the plaintiff. The settlement was not material to either the current or future years.

In September 2011, LVL Patent Group, LLC filed three complaints against us for patent infringement in the United States District Court for the District of Delaware. The complaints allege, among other things, that certain aspects of our technology, including our mobile applications, infringe four patents owned by the plaintiff purporting to cover a Telephone/Transaction Entry Device and System for Entering Transaction Data into Databases (U.S. Patent Nos. 5,805,676; 5,987,103; and 8,019,060) and a Data Transaction Assembly Server (U.S. Patent No. 6,044,382), and seek monetary damages, injunctive relief, costs, and attorneys fees. In August 2012, the court entered judgment declaring the 060 patent to be invalid; the case is proceeding with respect to the 676, 103, and 382 patents. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In December 2011, Personalweb Technologies LLC filed a complaint against Amazon.com, Inc. and Amazon Web Services LLC in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that Amazon Simple Storage Service (S3) and Amazon ElastiCache infringe U.S. Patent No. 5,978,791, entitled Data Processing System Using Substantially Unique Identifiers To Identify Data Items, Whereby Data Items Have The Same Identifiers ; U.S Patent No. 6,415,280, entitled Identifying And Requesting Data In Network Using Identifiers Which Are Based On Contents Of Data ; U.S Patent No. 6,928,442, entitled Enforcement And Policing Of Licensed Content Using Content-Based Identifiers ;

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U.S Patent No. 7,802,310, entitled Controlling Access To Data In A Data Processing System ; U.S. Patent No. 7,945,539, entitled Distributing And Accessing Data In A Data Processing System ; U.S. Patent No. 7,945,544, entitled Similarity-Based Access Control Of Data In A Data Processing System ; U.S. Patent No. 7,949,662, entitled De-Duplication Of Data In A Data Processing System ; and U.S Patent No. 8,001,096, entitled Computer File System Using Content-Dependent File Identifiers. The complaint seeks an unspecified amount of damages, interest, attorneys fees, and an injunction. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In December 2011, Round Rock Research, LLC filed a complaint against Amazon.com, Inc. in the United States District Court for the District of Delaware. The complaint alleges, among other things, that RFID products and Kindle products with unlicensed DRAM infringe U.S. Patent Nos. 5,500,650 and 5,627,544, entitled Data Communication Method Using Identification Protocol ; U.S. Patent No. 5,974,078, entitled Modulated Spread Spectrum In RF Identification Systems Method ; U.S. Patent No. 6,459,726, entitled Backscatter Interrogators, Communication Systems And Backscatter Communication Methods ; U.S. Patent No. RE41,531, entitled Communications Systems For Radio Frequency Identification (RFID) ; U.S. Patent Nos. 6,975,556 and 7,106,646, entitled Circuit And Method For Controlling A Clock Synchronizing Circuit For Low Power Refresh Operation ; U.S. Patent No. 7,221,020, entitled Method To Construct A Self Aligned Recess Gate For DRAM Access Devices ; and U.S. Patent No. 7,389,369, entitled Active Termination Control. In February 2012, the plaintiff filed an amended complaint that further alleges, among other things, that Kindle products allegedly including unlicensed flash memory infringe U.S. Patent No. 5,801,985, entitled Memory System Having Programmable Control Parameters and U.S. Patent No. 5,880,996, entitled Memory System Having Non-Volatile Data Storage Structure For Memory Control Parameters And Method. The complaint seeks an unspecified amount of damages, enhanced damages, interest, and attorneys fees. In April 2012, the case was stayed pending reexamination of ten of the asserted patents. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In March 2012, OIP Technologies, Inc. filed a complaint against us for patent infringement in the United States District Court for the Northern District of California. The complaint alleged, among other things, that certain aspects of our pricing methods infringed U.S. Patent No. 7,970,713, entitled Method and Apparatus for Automatic Pricing in Electronic Commerce. The complaint sought three times an unspecified amount of damages, attorneys fees, and interest. In September 2012, the Court invalidated the plaintiff s patent and dismissed the case with prejudice. In September 2012, OIP appealed the judgment of the district court to the United States Court of Appeals for the Federal Circuit, which, in November 2012, stayed all proceedings pending its decision in a separate case that raises a related question of law.

In May 2012, Clouding IP, LLC f/k/a/ STEC IP, LLC filed a complaint against Amazon.com, Inc. and Amazon Web Services, LLC in the United States District Court for the District of Delaware. The complaint alleges, among other things, that our Elastic Compute Cloud, WhisperSync, Virtual Private Cloud, Cloud Drive, and Kindle Store services infringe one or more of 11 patents: U.S. Patent Nos. 7,596,784, entitled Method System and Apparatus for Providing Pay-Per-Use Distributed Computing Resources ; 7,065,637, entitled System for Configuration of Dynamic Computing Environments Using a Visual Interface ; 6,738,799, entitled Methods and Apparatuses for File Synchronization and Updating Using a Signature List ; 5,944,839, entitled System and Method for Automatically Maintaining A Computer System ; 5,825,891, entitled Key Management for Network Communication ; 5,495,607, entitled Network Management System Having Virtual Catalog Overview of Files Distributively Stored Across Network Domain ; 6,925,481, entitled Technique for Enabling Remote Data Access And Manipulation From A Pervasive Device ; 7,254,621, entitled Technique for Enabling Remote Data Access And Manipulation From A Pervasive Device ; 6,631,449, entitled Dynamic Distributed Data System and Method ; 6,918,014, entitled Dynamic Distributed Data System and Method ; and 6,963,908, entitled System for Transferring Customized Hardware and Software Settings from One Computer to Another Computer to Provide Personalized Operating Environments. The complaint seeks an unspecified amount of damages together with interest. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

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In June 2012, Hand Held Products, Inc., a subsidiary of Honeywell, filed a complaint against Amazon.com, Inc., AMZN Mobile LLC, AmazonFresh LLC, A9.com, Inc., A9 Innovations LLC, and Quidsi, Inc. in the United States District Court for the District of Delaware. The complaint alleges, among other things, that the use of mobile barcode reader applications, including Amazon Mobile, Amazon Price Check, Flow, and AmazonFresh, infringes U.S. Patent No. 6,015,088, entitled Decoding of Real Time Video Imaging. The complaint seeks an unspecified amount of damages, interest, and an injunction. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In July 2012, Norman Blagman filed a purported class-action complaint against us for copyright infringement in the United States District Court for the Southern District of New York. The complaint alleges, among other things, that we sell digital music in our Amazon MP3 Store obtained from defendant Orchard Enterprises and other unnamed digital music aggregators without obtaining mechanical licenses for the compositions embodied in that music. The complaint seeks certification as a class action, statutory damages, attorneys fees, and interest. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In July 2012, Technology Properties Limited, Phoenix Digital Solutions LLC, and Patriot Scientific Corporation filed a complaint against us for patent infringement in the United States International Trade Commission and in the United States District Court for the Northern District of California. The complaints allege, among other things, that using the Kindle Fire in combination with certain peripheral devices infringes U.S. Patent No. 5,809,336, entitled High Performance Microprocessor Having Variable Speed System Clock. The ITC complaint seeks an exclusion order preventing the importation of Kindle Fire into the United States. The district court complaint asserts infringement of two additional patents U.S. Patent Nos. 5,440,749 and 5,530,890, both entitled High Performance, Low Cost Microprocessor Architecture and seeks an unspecified amount of damages, enhanced damages, attorneys fees, interest, and an injunction. In a November 2012 letter to the Company plaintiff alleged specifically that, if we are found to infringe the patents-in-suit and the patents are found to be valid (both of which we dispute), Amazon and its affiliates should pay damages of approximately $42 million, subject to enhancement, plus $17 million in prejudgment interest. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In August 2012, an Australian quasi-government entity named Commonwealth Scientific and Industrial Research Organization filed a complaint against us in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that the sale of products which are operable according to the Institute of Electrical and Electronics Engineers (IEEE) 802.11a, g, n, and/or draft n standards infringe U.S. Patent No. 5,487,069, entitled Wireless LAN. The complaint seeks an unspecified amount of damages, enhanced damages, attorneys fees, and injunctive relief. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In September 2012, B.E. Technology, LLC filed a complaint against Amazon Digital Services, Inc. in the United States District Court for the Western District of Tennessee. The complaint alleges, among other things, that Kindle, Kindle Touch, Kindle Touch 3G, Kindle Keyboard 3G, Kindle DX, and Kindle Fire infringe U.S. Patent No. 6,771,290, entitled Computer Interface Method And Apparatus With Portable Network Organization System And Targeted Advertising. The complaint seeks an unspecified amount of damages, interest, and injunctive relief. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

In November 2012, Innovative Automation LLC filed a complaint against Amazon.com, Inc., Audible, Inc., and On-Demand Publishing LLC dba CreateSpace in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that Amazon products and services relating to Kindle content distribution, Audible audiobooks, Amazon Cloud Player, and on-demand CD and DVD duplication infringe U.S. Patent Nos. 7,392,283 and 7,174,362, both entitled Method and System for Supplying Products and Pre-Stored Digital Data in Response to Demands Transmitted Via Computer Network. The complaint seeks an

unspecified amount of damages, interest, and injunctive relief. We dispute the allegations of wrongdoing and intend to vigorously defend ourselves in this matter.

We cannot predict the impact (if any) that any of the matters described above may have on our business, results of operations, financial position, or cash flows. Because of the inherent uncertainties of such matters, including the early stage and lack of specific damage claims in many of them, we cannot estimate the range of possible losses from them (except as otherwise indicated).

See also Note 11 Income Taxes.

Note 9 STOCKHOLDERS EQUITY

Preferred Stock

We have authorized 500 million shares of $0.01 par value Preferred Stock. No preferred stock was outstanding for any period presented.

Common Stock

Common shares outstanding plus shares underlying outstanding stock awards totaled 470 million, 468 million, and 465 million, at December 31, 2012, 2011, and 2010. These totals include all vested and unvested stock-based awards outstanding, including those awards we estimate will be forfeited.

Stock Repurchase Activity

In January 2010, our Board of Directors authorized the Company to repurchase up to $2.0 billion of our common stock with no fixed expiration. We have $763 million remaining under the $2.0 billion repurchase program.

Stock Award Plans

Employees vest in restricted stock unit awards over the corresponding service term, generally between two and five years.

Stock Award Activity

The following summarizes our restricted stock unit activity (in millions):

	Number of Units		Weighted Average Grant-Date Fair Value
Outstanding at January 1, 2010	15.7	$	66.75
Units granted	5.3		140.43
Units vested	(5.7)		60.44
Units forfeited	(1.3)		82.85
Outstanding at December 31, 2010	14.0	$	95.86
Units granted	5.4		192.82
Units vested	(5.1)		72.51
Units forfeited	(1.2)		122.17
Outstanding at December 31, 2011	13.1	$	142.54
Units granted	8.2		209.30
Units vested	(4.2)		109.67

Units forfeited	(1.7)		168.20
Outstanding at December 31, 2012	15.4	$	184.29

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Scheduled vesting for outstanding restricted stock units at December 31, 2012 is as follows (in millions):

	Year Ended December 31,						
	2013	2014	2015	2016	2017	Thereafter	Total
Scheduled vesting restricted stock units	4.8	5.2	3.2	1.7	0.3	0.2	15.4

As of December 31, 2012, there was $1.3 billion of net unrecognized compensation cost related to unvested stock-based compensation arrangements. This compensation is recognized on an accelerated basis with approximately half of the compensation expected to be expensed in the next twelve months, and has a weighted average recognition period of 1.2 years.

During 2012 and 2011, the fair value of restricted stock units that vested was $928 million and $1.0 billion.

As matching contributions under our 401(k) savings plan, we granted 0.1 million shares of common stock in 2012 and 2011. Shares granted as matching contributions under our 401(k) plan are included in outstanding common stock when issued.

Common Stock Available for Future Issuance

At December 31, 2012, common stock available for future issuance to employees is 149 million shares.

Note 10 ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Changes in the composition of accumulated other comprehensive income (loss) for 2012, 2011, and 2010 are as follows (in millions):

	Foreign currency translation adjustments	Unrealized gains on available-for-sale securities	Total
Balances as of January 1, 2010	$ (66)	$ 10	$ (56)
Other comprehensive income (loss)	(137)	3	(134)
Balances as of December 31, 2010	$ (203)	$ 13	$ (190)
Other comprehensive income (loss)	(123)	(3)	(126)
Balances as of December 31, 2011	$ (326)	$ 10	$ (316)
Other comprehensive income (loss)	76	1	77
Balances as of December 31, 2012	$ (250)	$ 11	$ (239)

Amounts included in accumulated other comprehensive income (loss) are recorded net of their related income tax effects.

Note 11 INCOME TAXES

In 2012, 2011, and 2010, we recorded net tax provisions of $428 million, $291 million, and $352 million. A majority of this provision is non-cash. We have tax benefits relating to excess stock-based compensation that are being utilized to reduce our U.S. taxable income. As such, cash taxes paid, net of refunds, were $112 million, $33 million, and $75 million for 2012, 2011, and 2010.

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The components of the provision for income taxes, net are as follows (in millions):

	Year Ended December 31,		
	2012	**2011**	**2010**
Current taxes:			
U.S. and state	$ 562	$ 103	$ 311
International	131	52	37
Current taxes	693	155	348
Deferred taxes:			
U.S. and state	(156)	157	1
International	(109)	(21)	3
Deferred taxes	(265)	136	4
Provision for income taxes, net	$ 428	$ 291	$ 352

U.S. and international components of income before income taxes are as follows (in millions):

	Year Ended December 31,		
	2012	**2011**	**2010**
U.S.	$ 882	$ 658	$ 886
International	(338)	276	611
Income before income taxes	$ 544	$ 934	$ 1,497

The items accounting for differences between income taxes computed at the federal statutory rate and the provision recorded for income taxes are as follows:

	Year Ended December 31,		
	2012	**2011**	**2010**
Federal statutory rate	35.0%	35.0%	35.0%
Effect of:			
Impact of foreign tax differential	31.5	(8.4)	(12.7)
State taxes, net of federal benefits	0.2	1.5	1.5
Tax credits	(4.4)	(3.2)	(1.1)
Nondeductible stock-based compensation	11.1	4.1	1.6
Other, net	5.2	2.2	(0.8)
Total	78.6%	31.2%	23.5%

Our effective tax rate in 2012, 2011, and 2010 was significantly affected by two factors: the favorable impact of earnings in lower tax rate jurisdictions and the adverse effect of losses incurred in certain foreign jurisdictions for which we may not realize a tax benefit. Income earned in lower tax jurisdictions is primarily related to our European operations, which are headquartered in Luxembourg. Losses incurred in foreign jurisdictions for which we may not realize a tax benefit, primarily generated by subsidiaries located outside of Europe, reduce our pre-tax income without a corresponding reduction in our tax expense, and therefore increase our effective tax rate. We have recorded a valuation allowance against the related deferred tax assets.

In 2012, the adverse impact of such foreign jurisdiction losses was partially offset by the favorable impact of earnings in lower tax rate jurisdictions. Additionally, our effective tax rate in 2012 was more volatile as compared to prior years due to the lower level of pre-tax income generated during the year, relative to our tax expense. For example, the impact of non-deductible expenses on our effective tax rate was greater as a result of our lower pre-tax income. Our effective tax rate in 2012 was also adversely impacted by acquisitions (including integrations) and investments, audit developments, nondeductible expenses, and changes in tax law such as the

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expiration of the U.S. federal research and development credit at the end of 2011. These items collectively caused our annual effective tax rate to be higher than both the 35% U.S. federal statutory rate and our effective tax rates in 2011 and 2010.

In 2011 and 2010, the favorable impact of earnings in lower tax rate jurisdictions offset the adverse impact of foreign jurisdiction losses and as a result, the effective tax rate in both years was lower than the 35% U.S. federal statutory rate.

Deferred income tax assets and liabilities are as follows (in millions):

	Year Ended December 31,	
	2012	**2011**
Deferred tax assets:		
Net operating losses U.S. - Federal/States (1)	$ 47	$ 43
Net operating losses foreign (2)	289	113
Accrued liabilities, reserves, & other expenses	482	412
Stock-based compensation	281	178
Deferred revenue	129	41
Assets held for investment	129	64
Other items	133	98
Tax credits (3)	12	7
Total gross deferred tax assets		