Case Study

Amazon.com, Inc. – Early Development and Financing

At age 31, Jeffrey Bezos resigned his position as Senior Vice President of D. E. Shaw & Co., a Wall Street investment firm, to found an Internet venture. Bezos, who holds a B.S. degree in Electrical Engineering and Computer Science from Princeton University, had been searching systematically for a way to participate in the growth of retailing on the Internet. After considering a number of alternatives, he settled on the idea of establishing an online bookstore.

Overview

Amazon.com was founded in Seattle, Washington in July 1994 with an initial investment of $10,000 by Bezos. The entire first year of the venture's existence was devoted to development of infrastructure: designing the website, establishing relations with distributors, developing software to manage book orders and deliveries, designing a search engine, and developing the software to manage the cash flow of the venture. For the most part, development efforts were performed by Bezos, himself.

Amazon.com opened for business on the Internet in July 1995, billing itself as "Earth's Biggest Bookstore." The Company offers over 2.5 million titles, including most of the 1.5 million of the English-language titles currently in print. By contrast, even the largest traditional bookstore does not carry more than 175,000 titles in inventory.

The Company's objective is to become "the leading online retailer of information-based products and services, with an initial focus on books." Amazon expects to compete against traditional bookstores by offering books that are in high demand at discount prices that are difficult for the traditional bookstores to match and by offering convenience and information that cannot be duplicated by traditional bookstores.

Amazon's reliance on the Internet affords it a cost advantage that cannot be duplicated by traditional bookstores. The Company hopes to compete against the potential emergence of competition of other Internet book sellers by building customer loyalty, maintaining technological leadership, building a strong brandname, being strongly service-oriented, and capitalizing on incremental revenue opportunities. Since the range of services is always changing, the best way to understand the Company's strategy is to visit its website, http://www.amazon.com/ .

The retail book market is large and growing. By the year 2000, annual U.S. book sales are projected by Euromonitor to reach $30 billion and worldwide book sales are projected to reach $90 billion. The two largest U.S. retailers account for less than 25 percent of the U.S. market. Amazon.com views its market as world-wide. As of year end 1996, the Company had approximately 180,000 customers and was receiving regular book orders from more than 100 countries.

Financing

Exhibit 1 contains a chronology of Company financing from 1994 through early 1998. Exhibit 2 contains a summary of the financial statements of Amazon.com during the Company's early years of operation, and for the first quarters of 1997 and 1998.[1] The Company has a December 31 fiscal year end so the statements do not reflect the effect of the debt restructuring in May of 1998.[2]

Also, in April 1998, the Company announced that it acquired three Internet companies: Bookpages Limited (in the United Kingdom), Telebook, Inc. (in Germany), and Internet Movie Database Limited. The acquisitions were made in exchange for 540,000 shares of common stock and the Company incurred $55 million in charges associated with the acquisitions.

Status

As of summer 1998, Hoover's Online (http://www.hovers.com/) reports that Amazon.com has customers in more than 150 countries and all 50 states. The Company is integrating into online sales of music and video. Jeffrey Bezos and family members own 48 percent of the Company, and two Kleiner Perkins Caufield & Byers venture capital funds own 12 percent. In total, 42 percent of the stock is owned by institutions. With an annual salary of $79,197, Bezos is among the lower paid members of the management team.

The IPO occurred in 1997 and was priced at $18 per share. In April 1998 the Company announced a 2 for 1 stock split. The closing stock price of Amazon.com on July 2, 1998 was $124 per share (after the split), resulting in a market capitalization of $6.1 billion. The stock price was 28 times annual sales revenue for the prior 12 months and 310 times book value per share. Exhibit 3 shows the price performance of Amazon.com stock from the IPO in 1997 to July 1998.

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[1] Per share figures in Exhibit 2 reflect a 2 for 1 stock split after the end of the first quarter of 1998. Per share figure in Exhibit 1 are adjusted for the split.

[2] The IPO prospectus and the 1997 10-K are available in the Resources file for this case.

Exhibit 1

Summary of Financing Activities of Amazon.com		
Date	**Amount**	**Terms**
July 1994	$10,000	From Jeffrey Bezos, in exchange for 10,200,000 shares of common stock ($.001 per share).[3]
July 5, 1994	$15,000	Interest-free loan from Jeffrey Bezos. Repaid August 1995.
November 1994	$29,000	Interest-free loan from Jeffrey Bezos. Repaid April 1995.
November 1994		Jeffrey Bezos personal guarantee of obligations to Seafirst Bank.
February 9, 1995	$100,000	From Miguel Bezos (father of Jeffrey), in exchange for 582,528 shares of common stock ($.1717 per share).
April 1995		Jeffrey Bezos personal guarantee of Company credit cards.
July 1995		Jeffrey Bezos personal guarantee of obligations to Wells Fargo Bank.
July 24, 1995	$145,500	From Gise Family Trust, Jacklyn Gise Bezos (mother of Jeffery), Trustee, for 847,716 shares of common stock ($.1717 per share).
August 7, 1995	$5,408	An employee, for 42,000 shares of common stock ($.1287 per share).
November 1995	$40,000	Interest-free loan from Jeffrey Bezos. Repaid November 1995.
December 6, 1995	$50,000	From Tom Alberg, preferred shares convertible to 150,000 shares of common stock ($.3333 per share). Alberg became a Company director in June 1996, and a senior officer of both McCaw Cellular and LIN Broadcasting until October 1995, when they were acquired by AT&T.
May 1996	$117,200	To family member at price established in December 1995 ($.1717 per share).
May 3, 1996	$20,000	From Mark Bezos and Christina Bezos Poore (siblings of Jeffrey), for preferred shares convertible to 60,000 shares of common stock ($.3333 per share).

[3] If the Company proposes to register any of its securities for its own account or the account of other security holders, Jeffrey Bezos has the right to include shares in the registration at Company expense. The underwriter, in a public issue, may limit the number of shares in such a registration.

December 6, 1995 To May 16, 1996	$937,000	From 20 other investors as a private placement, for preferred shares convertibile to 2,811,000 shares of common stock ($.3333 per share). Average investment, $46,850 per investor.
June 21, 1996	$8,000,014	From two venture capital funds managed by Kleiner Perkins Caufield & Byers, for 569,396 shares of preferred stock, each share convertible to 6 shares of common stock, (at a value per common share of $2.3417).[4]
January 1997 and February 1997	$200,000	Equally from Scott D. Cook and Patricia Q Stonesifer (new members of the Amazon board), for 30,000 shares of convertible preferred stock, (at a value of $6.6667 per common share).[5]
May 15, 1997	$49,100,000	Net proceeds of initial public offering of 3,000,000 shares at $18.00. All outstanding preferred stock was converted to common at the time of the IPO.[6]
December 23, 1997	$75,000,000	Senior secured variable rate term loan at LIBOR plus 4% or a comparable rate, and with warrants to purchase 750,000 shares of common stock at an exercise price of $52.11 per share.
May 8, 1998	$326,000,000	Public issue of 10% Senior Discount Notes due 2008 (sold at discount from $530 million par value, with no interest payments to be made until 2003). Proceeds used to retire $75 million of existing debt (including cancellation of warrants) and for other purposes.

[4] In connection with the preferred stock investment, L. John Doerr, and General Partner of Kleiner Perkins Caufield & Byers joined the board of Amazon.com. If the Company proposes to register any of its securities for its own account or the account of other security holders, KPCB has the right to include shares in the registration at Company expense. In addition KPCB has demand registration rights, pursuant to which it may require the Company to file a registration statement. The underwriter, in a public issue, may limit the number of shares in such a registration.

[5] Scott Cook, co-founder of Intuit, joined the board in January 1997, and Patricia Stonesifer, an independent management consultant, joined in February 1997.

[6] In addition to the listed transactions before the IPO, the company issued 2,136.444 shares at various times to licensees or through exercise of stock options, bringing the total outstanding after the IPO to 23,858,702 common shares.

Exhibit 2[7]

Summary of Amazon.com Inc. Financial Statements

	Annual Information (Thousands)					
	1997	1996	1995	1994	1998-Q1	1997-Q1
Statement of Operations						
Net Sales	$147,758	$15,746	$511	$0	$87,357	$16,005
Cost of Sales	$118,945	$12,287	$409	$0	$68,054	$12,484
Gross Profit	$28,813	$3,459	$102	$0	$19,303	$3,521
Operating Expenses						
Marketing and Sales	$38,964	$6,090	$200	$0	$19,503	$3,906
Product Development	$12,485	$2,313	$171	$38	$6,729	$1,575
General and Administrative	$6,573	$1,035	$35	$14	$1,963	$1,142
Total Operating Expenses	$58,022	$9,438	$406	$52	$28,195	$6,623
Gain (Loss) from Operations	($29,209)	($5,979)	($304)	($52)	($8,892)	($3,102)
Interest Income	$1,898	$202	$1	$0	$1,640	$64
Interest Expense	($279)	$0	$0	$0	($2,025)	$0
Net Loss	($27,590)	($5,777)	($303)	($52)	($9,277)	($3,038)
Shares (fully diluted and adjusted for 2 for 1 split)	43,302	37,088	28,786	26,382	46,622	38,804
Gain (Loss) per Share	($0.64)	($0.16)	($0.01)	($0.00)	($0.20)	($0.08)

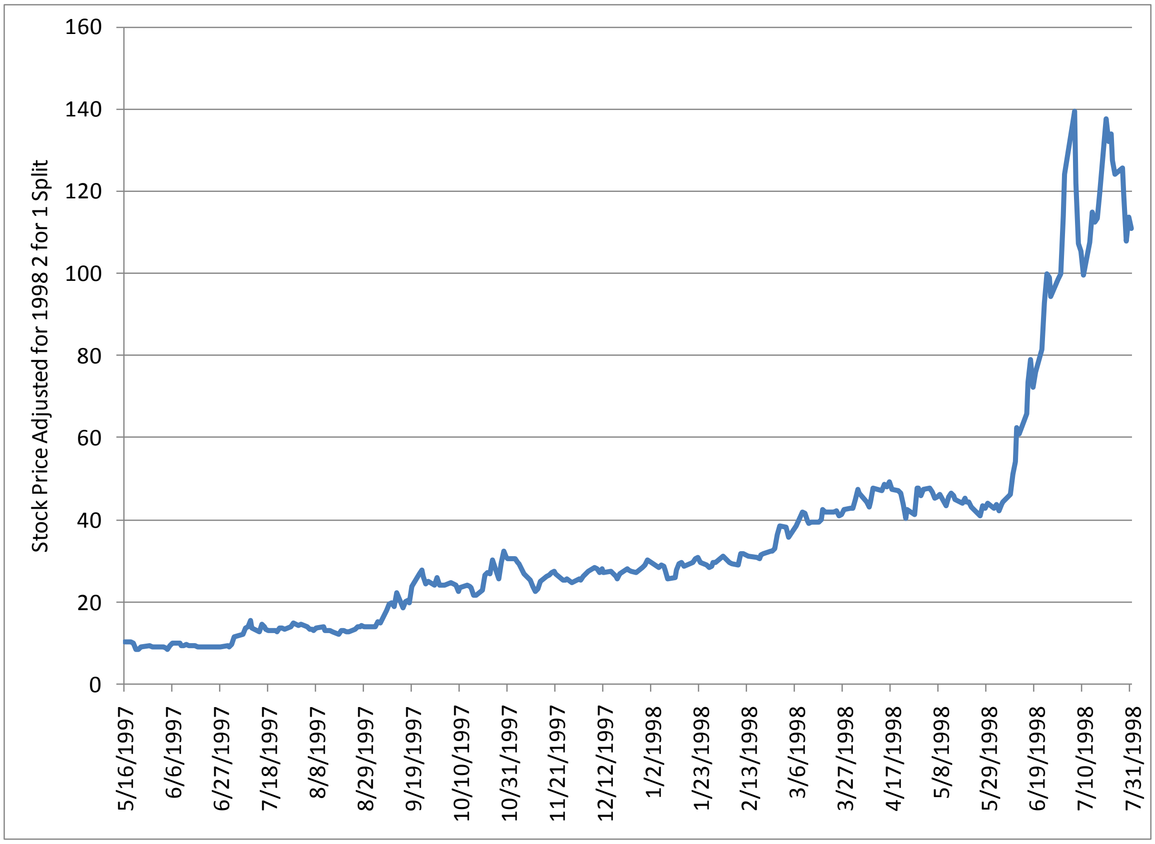
[7] An Excel file of this figure is available.

	Annual Information (Thousands)					
	1997	1996	1995	1994	1998-Q1	1997-Q1
Balance Sheet Data						
Cash and Equivalents	$109,810	$6,248	$996	$52	$98,600	$109,810
Working Capital	$93,517	$2,270	$920	($16)	$84,415	$93,517
Total Assets	$149,006	$8,271	$1,084	$76	$145,007	$149,006
Long-term Debt	$76,702	$0	$0	$0	$76,702	$76,702
Stockholders' Equity	$28,486	$3,401	$977	$8	$19,827	$28,486
Assets per Share	$3.44	$0.22	$0.04	$0.00	$3.11	$3.84
Equity per Share	$0.66	$0.09	$0.03	$0.00	$0.43	$0.73

	Annual Information (Thousands)					
	1997	**1996**	**1995**	**1994**	**1998-Q1**	**1997-Q1**
Statement of Cash Flows						
OPERATING ACTIVITIES						
Net Loss	($27,590)	($5,777)	($303)		($9,259)	($3,038)
Depreciation and Amortization	$4,742	$286	$19		$1,975	$683
Changes in Oper. Assets and Liab.						
Inventories	($8,400)	($554)	($17)		($2,703)	($368)
Prepaid Expenses	($2,977)	($307)	($14)		($1,101)	($616)
Deposits	($20)	($146)			($127)	($47)
Accounts Payable	$29,845	$2,753	$99		$1,677	$2,798
Accrued Advertising	$2,856	$598	$0		$1,895	$656
Other Accrued Expenses	$5,066	$1,412	($16)		$1,088	$1,135
Net Cash Used in Operations	$3,522	($1,735)	($232)		($6,555)	$1,203
INVESTING ACTIVITIES						
Net Purchases of Short-term Investments	($15,256)	$0	$0		($2,999)	$0
Purchases of Fixed Assets	($7,221)	($1,214)	($52)		($2,071)	($926)
Net Cash Used in Investing Activities	($22,477)	($1,214)	($52)		($5,070)	($926)
FINANCING ACTIVITIES						
Proceeds of Initial Public Offering	$49,103	$0	$0		$0	$0
Proceeds from Sale of Common Stock or Options	$518	$231	$1,272		$415	$437
Proceeds from Sale of Preferred Stock	$200	$7,970	$0		$0	$200
Proceeds from Borrowing (Repayment)	$75,000	$0	($44)		$0	$0
Financing Costs	($2,304)	$0	$0		$0	$0
Net Cash from Financing Activities	$122,517	$8,201	$1,228		$415	$637
Increase in Cash and Equivalents	$103,562	$5,252	$944		($11,210)	$914

Exhibit 3[8]

Stock Price Performance of Amazon.com



[8] An Excel file of this figure is available.

References

Amazon.com Form S-1 filed with SEC March 24, 1997.

Amazon.com Prospectus dated May 15, 1997.

Amazon.com Form 10-K for the year ended December 31, 1997.

Amazon.com Form 10-Q for the quarter ended March 31, 1998.

Yahoo Finance for Amazon listing.

Discussion Questions

1. What milestones do you think would have been appropriate for Amazon.com to establish for itself to help evaluate the merits of the venture and to attract outside funding?

2. How would you characterize the various stages of development that the Company has gone through up to this point? How do you distinguish among the various stages?

3. What stages of financing has the Company gone through? How do the financing stages correspond to the milestones you identified in question 1, and the development stages in question 2?

4. How has the valuation of the Company changed over time? What roles do the special terms play in the venture capital financing and in the private debt issue?

5. Consider the IPO in the summer of 1997. Why do you think Amazon.com decided to do a public offering at that time? Why do you think investors were receptive to the offering?

6. In general terms, what do you think of the price of Amazon.com stock as of July 1998? What sorts of product market performance will the Company need to achieve to justify the price? Can you think of any reasons for the rapid increase in price beginning in June of 1998?