

AMAZON.COM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

sheets as hedging offsets to currency gains and losses on the Euro-denominated investments. As the hedge does not qualify for hedge accounting under the provisions of SFAS 133, commencing January 1, 2001, the foreign currency change resulting from the portion of the 6.875% PEACS previously hedging the available-for-sale securities is now being recorded on the consolidated statements of operations. For 2001, the remeasurement of the 6.875% PEACS resulted in a gain of \$47 million consisting of a \$10 million gain reclassified from “Accumulated other comprehensive loss,” and a \$37 million gain attributable to remeasurement of the 6.875% PEACS during the period.

During 2001 and 2000, the Company recorded impairment losses, which totaled \$44 million and \$189 million, respectively, relating to other-than-temporary declines in certain equity investments. These impairments were recorded to reflect the investments at fair value as of the date of impairment. During 2001, the other-than-temporary declines in fair value of investments were associated with investments in Webvan Group, Inc, Sotheby’s Holdings, Inc., WeddingChannel.com, Inc., Ashford.com, Inc., Audible, Inc., drugstore.com, inc., and Angel II Investors, L.P. During 2000, the other-than-temporary declines in fair value of investments were associated with Audible, NextCard, Inc., Webvan, Ashford.com, Greg Manning Auctions, Inc, and Sotheby’s.

On February 5, 2001, the Company terminated its commercial agreement with Kozmo.com and recorded a non-cash gain of \$22 million, representing the amount of unearned revenue associated with the contract. Since services had not yet been performed under the contract, no amounts associated with this commercial agreement were recognized in “Net sales” during any period. Furthermore, during 1999, the Company made a cash investment of \$60 million to acquire preferred stock of Kozmo.com and accounted for its investment under the equity method of accounting. Pursuant to the equity method of accounting, the Company recorded its share of Kozmo.com losses, which, during 2000, reduced the Company’s basis in its investment to zero. Accordingly, when Kozmo.com announced its intentions to cease operations on April 12, 2001, the Company did not have any further loss exposure relating to its investment. The Company will not recover any portion of its investment in Kozmo.com.

During 2000, the Company recorded a gain of \$40 million relating to the acquisition of Homegrocer.com by Webvan and a \$6 million net gain relating to the bankruptcy of Living.com that is comprised of a \$14 million loss representing the Company’s remaining investment balance in Living.com and a \$20 million gain relating to the unamortized portion of unearned revenue associated with the Living.com commercial agreement.

Note 14—INCOME TAXES

The Company has provided for current and deferred U.S. federal, state and foreign income taxes for the current and all prior periods presented. Current and deferred income taxes were provided with respect to jurisdictions where subsidiaries of the Company produce taxable income. As of December 31, 2001, the Company has a net deferred tax asset of \$2 million, which consists primarily of state net operating loss carryforwards. The Company has provided a valuation allowance for the remainder of its deferred tax asset, consisting primarily of net operating loss carry forwards, because of uncertainty regarding its realization. The increase in the valuation allowance on the deferred tax asset was \$492 million and \$226 million for 2001 and 2000, respectively.

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Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

	December 31,	
	2001	2000
	(in thousands)	
Net operating loss carryforwards	\$ 769,632	\$ 576,024
Equity in losses of equity-method investees	152,502	—
Depreciation and amortization	148,450	9,777
Accrued expenses	53,186	32,050
Unearned revenue	37,834	39,916
Other	9,674	19,435
Total deferred tax assets	1,171,278	677,202
Valuation allowance for deferred tax assets	(1,169,130)	(677,202)
Net deferred tax assets	\$ 2,148	\$ —

At December 31, 2001, the Company had net operating loss carryforwards of approximately \$2.3 billion related to U.S. federal, state and foreign jurisdictions. Utilization of net operating losses, which begin to expire at various times starting in 2010, may be subject to certain limitations. Approximately \$1 billion of the Company's net operating loss carryforwards relates to deductible stock-based compensation in excess of amounts recognized for financial reporting purposes. To the extent that net operating loss carryforwards, if realized, relate to the portion associated with stock-based compensation, the resulting benefit will be credited to stockholders' equity, rather than results of operations.

Note 15—EMPLOYEE BENEFIT PLAN

The Company has a 401(k) savings plan covering substantially all of its employees. Eligible employees may contribute through payroll deductions. The Company matches employees' contributions at the discretion of the Company's Board of Directors. To date, the Company has not matched employee contributions to the 401(k) savings plan.

Note 16—SEGMENT INFORMATION

In January 2001, the Company began presenting information to its chief operating decision maker in four segments: U.S. Books, Music and DVD/Video; U.S. Electronics, Tools and Kitchen; Services; and International. Accordingly, the Company is now disclosing its segment financial information along these lines. Allocation methodologies are consistent with past presentations, and prior period amounts have been reclassified to conform with the current period presentation.

U.S. Books, Music and DVD/Video Segment

The U.S. Books, Music and DVD/Video Segment includes revenues, direct costs, and cost allocations associated with retail sales from *www.amazon.com* for books, music and DVDs/video products and for magazine subscriptions. This segment also includes product sales, commissions, direct costs and cost allocations from sales of these products, new or used, through Amazon Marketplace and from stores offering these products through the Company's Syndicated Stores Program, such as *www.borders.com*.