



To our shareholders:

In many ways, Amazon.com is not a normal store. We have deep selection that is unconstrained by shelf space. We turn our inventory 19 times in a year. We personalize the store for each and every customer. We trade real estate for technology (which gets cheaper and more capable every year). We display customer reviews critical of our products. You can make a purchase with a few seconds and one click. We put used products next to new ones so you can choose. We share our prime real estate—our product detail pages—with third parties, and, if they can offer better value, we let them.

One of our most exciting peculiarities is poorly understood. People see that we're determined to offer both world-leading customer experience *and* the lowest possible prices, but to some this dual goal seems paradoxical if not downright quixotic. Traditional stores face a time-tested tradeoff between offering high-touch customer experience on the one hand and the lowest possible prices on the other. How can Amazon.com be trying to do both?

The answer is that we transform much of customer experience—such as unmatched selection, extensive product information, personalized recommendations, and other new software features—into largely a fixed expense. With customer experience costs largely fixed (more like a publishing model than a retailing model), our costs as a percentage of sales can shrink rapidly as we grow our business. Moreover, customer experience costs that remain variable—such as the variable portion of fulfillment costs—improve in our model as we reduce defects. Eliminating defects improves costs and leads to better customer experience.

We believe our ability to lower prices and simultaneously drive customer experience is a big deal, and this past year offers evidence that the strategy is working.

First, we do continue to drive customer experience. The holiday season this year is one example. While delivering a record number of units to customers, we also delivered our best-ever experience. Cycle time, the amount of time taken by our fulfillment centers to process an order, improved 17% compared with last year. And our most sensitive measure of customer satisfaction, contacts per order, saw a 13% improvement.

Inside existing product categories, we've worked hard to increase selection. Electronics selection is up over 40% in the U.S. alone over the prior year, and we now offer 10 times the selection of a typical big box electronics store. Even in U.S. books, where we've been working for 8 years, we increased selection by 15%, mostly in harder-to-find and out-of-print titles. And, of course, we've added new categories. Our Apparel and Accessories store has more than 500 top clothing brands, and in its first 60 days, customers bought 153,000 shirts, 106,000 pairs of pants, and 31,000 pairs of underwear.

In this year's American Customer Satisfaction Index, the most authoritative study of customer satisfaction, Amazon.com scored an 88, the highest score ever recorded—not just online, not just in retailing—but the highest score ever recorded in any service industry. In ACSI's words:

“Amazon.com continues to show remarkably high levels of customer satisfaction. With a score of 88 (up 5%), it is generating satisfaction at a level unheard of in the service industry.... Can customer satisfaction for Amazon climb more? The latest ACSI data suggest that it is indeed possible. Both service and the value proposition offered by Amazon have increased at a steep rate.”

Second, while focused on customer experience, we've also been lowering price substantially. We've been doing so broadly across product categories, from books to electronics, and we've eliminated shipping fees with our 365 day-per-year Free Super Saver Shipping on orders over \$25. We've been taking similar actions in every country in which we do business.

Our pricing objective is not to discount a small number of products for a limited period of time, but to offer low prices everyday and apply them broadly across our entire product range. To illustrate this point, we recently did a price comparison versus a major well-known chain of book superstores. We did not hand pick a choice group of books against which we wanted to compare. Instead, we used their published list of their 100 bestsellers for 2002. It was a good representation of the kinds of books people buy most, consisting of 45 hardcover titles and 55 paperbacks across many different categories, including Literature, Romance, Mystery and Thrillers, Nonfiction, Children's, Self-Help, and so on.

We priced all 100 titles by visiting their superstores in both Seattle and New York City. It took us six hours in four of their different superstores to find all 100 books on their list. When we added up everything we spent, we discovered that:

- At their stores, these 100 bestselling books cost \$1,561. At Amazon.com, the same books cost \$1,195 for a total savings of \$366, or 23%.
- For 72 of the 100 books, our price was cheaper. On 25 of the books, our price was the same. On 3 of the 100, their prices were better (we subsequently reduced our prices on these three books).
- In these physical-world superstores, only 15 of their 100 titles were discounted—they were selling the other 85 at full list price. At Amazon.com, 76 of the 100 were discounted and 24 were sold at list price.

To be sure, you may find reasons to shop in the physical world—for instance, if you need something immediately—but, if you do so, you'll be paying a premium. If you want to save money and time, you'll do better by shopping at Amazon.com.

Third, our determination to deliver low price *and* customer experience is generating financial results. Net sales this year increased 26% to a record \$3.9 billion, and unit sales

grew at an even faster 34%. Free cash flow—our most important financial measure—reached \$135 million, a \$305 million improvement over the prior year.¹

In short, what's good for customers is good for shareholders.

Once again this year, I attach a copy of our original 1997 letter and encourage current and prospective shareowners to take a look at it. Given how much we've grown and how much the Internet has evolved, it's notable that the fundamentals of how we do business remain the same.

As always, we at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

A handwritten signature in black ink that reads "Jeff P. Bezos". The signature is written in a cursive, flowing style.

Jeffrey P. Bezos
Founder and Chief Executive Officer
Amazon.com, Inc.

¹ Free cash flow for 2002 of \$135 million is net cash provided by operating activities of \$174 million less purchases of fixed assets of \$39 million. Free cash flow for 2001 of negative \$170 million is net cash used in operating activities of \$120 million less purchases of fixed assets of \$50 million.