Shareholder Letters: Accounting Themes

Free cash flow per share

Amazon letters: 2004, 2002, 2001

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What the Letter Says

> *"Our ultimate financial measure, and the one we most want to drive over the long-term, is free cash flow per share."*
>
> Jeffrey P. Bezos, 2004 letter

- Key letters: 2004, 2002, 2001
- Course fit: ACC250 Ch9 · ACC531 Analytics · Difficulty: Intro

Step 1: Start with Operating Cash Flow

- **Net cash from operating activities** (CFO): cash from running the business (customers in, suppliers and employees out).
- Found in the first section of the statement of cash flows.

EX. Amazon 2002: net cash provided by operating activities = **$174 million**.

Step 2: Subtract Capital Expenditures

- **Capital expenditures** (capex) = purchases of fixed assets (PPE), in the investing section.
- **Free cash flow** = CFO − capex: cash left after keeping and growing the asset base.

Amazon ($ millions)	2001	2002
Net cash from operating activities	(120)	174
− Purchases of fixed assets	(50)	(39)
Free cash flow	(170)	135

Amounts from the 2002 letter's footnote.

Step 3: Divide by Shares Outstanding

EX. Free cash flow $120 million; 400 million shares outstanding.

	Amount
Free cash flow	$120M
÷ Shares outstanding	400M
Free cash flow per share	$0.30

- More shares (dilution) → less per share, even if free cash flow is the same.

Back to the Letter

- Bezos (2004): free cash flow per share is Amazon's "ultimate financial measure."
- Why not earnings? Earnings do not directly become cash: **working capital**, **capex** and **dilution** also matter.

Questions

1. In 2002 Amazon's net cash provided by operating activities was $174 million and its purchases of fixed assets were $39 million (2002 letter). What was its free cash flow ($ millions)?
2. Why does Bezos focus on free cash flow rather than earnings?

   A. Free cash flow ignores capital spending

   B. Earnings do not directly turn into cash: capital spending, working capital and new shares also matter

   C. Earnings are not audited

   D. Free cash flow is required by GAAP to be the headline number

Sources

- Jeffrey P. Bezos, 2004 letter (ir.aboutamazon.com)
- Jeffrey P. Bezos, 2002 letter (ir.aboutamazon.com)
- Jeffrey P. Bezos, 2001 letter (ir.aboutamazon.com)
- Reading packet and question sheet for this theme

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