Shareholder Letters: Accounting Themes

Operating cycle and inventory turnover

Amazon letters: 2004, 2002, 1999

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What the Letter Says

> *"We have a cash generative operating cycle because we turn our inventory quickly, collecting payments from our customers before payments are due to suppliers."*
>
> Jeffrey P. Bezos, 2004 letter

- Key letters: 2004, 2002, 1999
- Course fit: ACC250 Ch6, Ch8 · ACC531 Analytics · Difficulty: Intermediate

Step 1: Days in Inventory

- **Inventory turnover** = CGS ÷ average inventory.
- **Days in inventory** = 365 ÷ inventory turnover.

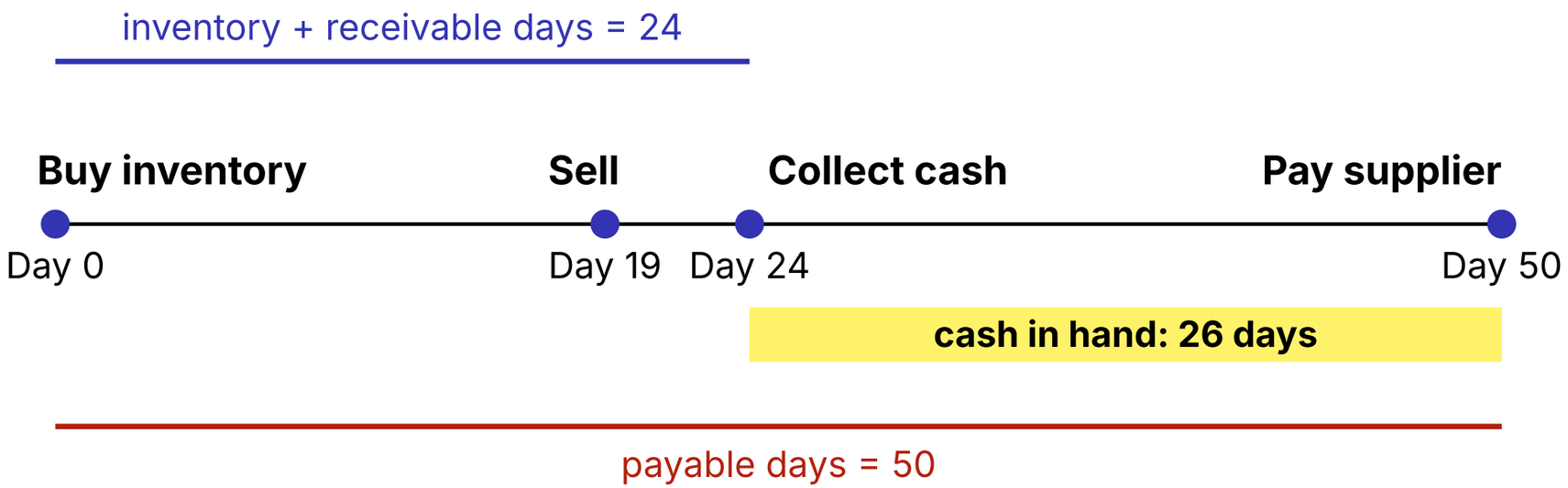
EX. Amazon (2002): inventory turns 19 times a year → 365 ÷ 19 ≈ **19 days**.

Step 2: Add Receivable Days, Subtract Payable Days

	Days
Days in inventory	19
+ Days of sales in A/R	5
− Accounts payable days	(50)
Operating cycle (letter’s definition)	(26)

- Customers pay by card within days; suppliers are paid later.

Step 3: See It on a Timeline



- Negative cycle: Amazon **collects before it pays**; suppliers finance its inventory.

Back to the Letter

- Bezos (2004): a “cash generative operating cycle”: turn inventory quickly and collect before paying suppliers.
- Bezos (1999, 2004): low inventory for its sales ($480 million of inventory on nearly $7 billion of sales in 2004).

Questions

1. Days of sales in inventory are 20, days of sales in accounts receivable are 5 and accounts payable days are 50. Using the letter's definition (inventory days + receivable days − payable days), what is the operating cycle (days; use a minus sign if negative)?
2. What does a negative operating cycle mean for Amazon?

   A. Its accounts receivable are uncollectible

   B. It collects cash from customers before it pays its suppliers

   C. It pays suppliers before it receives the goods

   D. Its inventory never sells

Sources

- Jeffrey P. Bezos, 2004 letter (ir.aboutamazon.com)
- Jeffrey P. Bezos, 2002 letter (ir.aboutamazon.com)
- Jeffrey P. Bezos, 1999 letter (ir.aboutamazon.com)
- Reading packet and question sheet for this theme

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