Shareholder Letters: Accounting Themes

Stock options and share dilution

Amazon letters: 2001, 1997

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What the Letter Says

> *“Limiting share count means more cash flow per share and more long-term value for owners.”*
>
> Jeffrey P. Bezos, 2001 letter

- Key letters: 2001, 1997
- Course fit: ACC250 Ch11 · ACC531 — · Difficulty: Intro

Step 1: Options Add Shares

EX. 400 million shares outstanding; employees exercise options for 12 million shares (3%).

Exercise:	Cash (+A)	120	
	Common Stock (+SE)		12
	APIC (+SE)		108

Exercise price $10 per share, par $1 (made-up numbers; $ millions).

Step 2: Same Cash Flow, More Shares

	Before	After
Free cash flow	$120M	$120M
Shares outstanding	400M	412M
Free cash flow per share	$0.300	$0.291

- **Dilution**: each existing share owns a smaller slice.

Step 3: Set a Limit

- Bezos (2001): target net dilution from employee options of about **3% per year** over five years.
- Paying in stock saves cash today but costs owners in per-share value.

Back to the Letter

- Bezos (1997): weight compensation toward stock options rather than cash.
- Bezos (2001): “Limiting share count means more cash flow per share and more long-term value for owners.”

Questions

1. A company has 400 million shares outstanding and targets net dilution from employee stock options of 3% this year. How many new shares does that add (millions)?
2. If free cash flow stays the same and the number of shares rises, free cash flow per share...

   A. rises

   B. stays the same

   C. doubles

   D. falls

Sources

- Jeffrey P. Bezos, 2001 letter (ir.aboutamazon.com)
- Jeffrey P. Bezos, 1997 letter (ir.aboutamazon.com)
- Reading packet and question sheet for this theme

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