

## Press Release

### **Amazon's Prime Pantry Phenomenon**

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"Done," Nicole Sherwood smiled proudly, laying her iPhone on the table. "I just finished off my Pantry order with a 12-pack of Diet Coke for \$3.99 and a box of Honey Nut Cheerios for \$3.59. Those prices are a lot better than Safeway – even better than I can get at my local Target or Wal-Mart. And it will be on my doorstep by Thursday, so no more trying to squeeze in a trip to the club store this weekend, between the kids' soccer games." She shakes her head, "I don't know how they do it, but I'm hooked." Nicole is one of the latest converts to Amazon Pantry, a year old service from Amazon that is transforming the shopping habits of thousands of customers and re-drawing the grocery retailing landscape at a remarkably fast rate.

Amazon's Pantry service is a store within Amazon.com, offering over 10k everyday staples that almost every US household purchases: beverages like colas and sports drinks, breakfast cereals, snacks, canned goods, condiments, boxed pastas and sides, and paper and plastic household goods. In fact, the Pantry best sellers are actually pretty ordinary. They are many of top selling dry-grocery items found in supermarkets around the county: Cheerios, Coca Cola, Triscuit crackers, Charmin toilet paper, Kraft Macaroni and Cheese, Starkist Tuna, Hellman's Mayonnaise. And while they don't carry all the national brands, they have an extensive selection of Amazon's own private label products. So what's all the fuss about? The price. Items in the Pantry store are typically equal to or lower than Wal-Mart and your local club stores. "My last order was about \$150. If I had bought the same stuff at my local supermarket, I'd be paying an extra \$30." The Pantry store does have a small box fee-- \$5.99 for every 50 pound order. "I was surprised with all that you can fit in 50 pounds –laundry detergent, toilet paper, paper towels, 12 pack of Coke, cat food, baby formula, canned soup, toothpaste and dish detergent, all in one box. For a lot of this stuff, I used to hold off buying until I could schlep the kids to Target or Wal-Mart to get a better price. Now I am paying even less with Pantry -- and without the hassle of a Target or Wal-Mart weekend trip."

The Pantry Store is accessible only to Amazon Prime members. Given the typical household spends \$600 or more per month on groceries, for most customers the cost of a Prime membership is not a big barrier when compared with the savings. "I've got 2 kids, a husband, and a dog," Nicole offered, "I'm usually starting a new order every two weeks." For Nicole, the Pantry Store was the trigger for joining Amazon Prime. "I'm a big Amazon shopper, but I mostly used Super Saver Shipping. 2-day Prime shipping and Prime Instant Videos were cool, but I couldn't quite justify the \$79 per year membership fee. When my sister turned me on to the Pantry, however, I jumped. I dropped my Costco membership, picked up Prime, and started shopping Pantry religiously." Amazon started with a large base of Prime members who began enjoying the Prime Pantry immediately. But even more interesting, thousands appear to be signing up for Amazon Prime, just to get access to the Pantry service and savings.

The Pantry store offers most Prime members the 2-day shipping promise they are used to and in select cities, Pantry orders are delivered next day. Doug Herrington, Amazon's VP of Consumables, explains: "We have created a network that uses ground shipping to keep costs and prices low yet most orders arrive within 2 days. Standard shipping in the Pantry Store is \$5.99 per box. Heavier orders, such as ones with lots of cola and bottled water, may require more than one box, depending on the total weight." Mr. Herrington adds, "Pantry offers exceptional value and convenience to our customers – but it is only available to Prime Members."

"Not since the initial launch of Amazon Mom have we seen this kind of switching from offline to online shopping," according to Bob Burns, a shopper behavior analyst for AC Nielsen. "We estimate 20k new customers a week are starting to shop the Pantry Store. With Amazon Mom, the change in shopping behavior was dramatic, but focused on diapers. What's been remarkable here is the breadth of products customers are switching from offline to online purchasing. A year ago, who would have thought Coke and Cheerios would be moving this much volume online?" Consumer Packaged Goods companies are very focused on Amazon. With tepid growth in the offline world, marketers are targeting Amazon to strengthen brand loyalty with the most productive and online savvy customers of Amazon. Industry veterans say it reminds them of the dramatic change in grocery shopping the warehouse club stores and mass merchants kicked off in the early 1980's. "Back then, it was the new discount formats like Wal-Mart and Costco that were pulling people out of the supermarkets in remarkable numbers, because they couldn't pass up the great prices," said Frank LaRue, a retail analyst for Morgan Stanley. "Today, Amazon's Pantry Store is causing a similar disruption by offering better prices and better convenience. And today this transformation is happening at hyper-speed."

Nicole is enjoying a cup of tea, savoring the serenity of shopping from her kitchen table. "I never liked that monthly pilgrimage to Target or Wal-Mart anyway, who does? But at the prices they offer for everyday staples, I used to feel lazy if I didn't at least try to buy a lot of my Pantry items there. But now I can get the same or better deal, whenever I want. And the best part of the Pantry Store? Getting my Saturday afternoons back."

#### **Frequently Asked Questions:**

*FAQ 1: Don't we already match leading mass merchants and club stores? What is new about Prime Pantry?*

Today we only match the online prices of image competitors. With Prime Pantry, we will offer selection that is not available online, and match or beat competitor in-store prices.

*FAQ 2: Is the unique Prime Pantry selection entirely new, or will items previously available to all customers in Amazon.com now be available only for Prime members?*

Most of the Prime Pantry selection will be new to Amazon. We may continue to sell larger packs of a given product in Amazon.com/Consumables, but only offer the single pack in the Prime Pantry. We may convert some unprofitable Add-On items to Prime Pantry, especially if we can offer them for a lower price. Finally, we may move the Retail items in some of our most profit challenged sub-categories, such as liquid laundry detergent, entirely into Prime Pantry.

*FAQ 3: Doesn't Amazon's Add-on program solve the low ASP problem?*

No. The Add-on program does help by incrementally lowering the ASPs we can sustainably offer for sale on Amazon, but it does not allow us to go as low as we need to go to serve the highest consumer demand. At today's product margin, the breakeven ASP for Add-on items in most Grocery categories is \$TK (versus an offline average of \$TK). And this breakeven would be much higher on mainstream CPG selection price-matched to offline retail. Finally, Add-on will not allow us to profitably sell heavy items like water or laundry detergent.

*FAQ 4: Why can't you offer FREE shipping over a certain \$ threshold?*

In the CPG space, a \$TK item can weigh one pound (e.g., a box of cereal), 10-pounds (e.g., a 12-pack of Coke), or 30-lbs (e.g., a case of bottled water). As long as our transportation costs are weight-driven, we

have to have a rate card that is order-weight aware. We have eliminated an order size charge in favor of a simpler customer message: \$5.99 for every 50 pound Pantry box.

*FAQ 5: Why launch with TK ASINs?*

We are viewing our launch ASIN count as an output of our negotiations with vendors in each product category. TK is our estimate for ASIN count based on our curated mix of ASINs that cover ~TK% of market segment demand per category in total and/or individually have 1% or greater of unit share of sales in the IRI and Fresh data we have analyzed.

*FAQ 6: Why not limit Pantry to certain flavors of Prime?*

Prime is launching a few variations of Prime in 2013 and will continue to do so in the future. At this time, we plan to open the Pantry store to all Prime members regardless of plan or stage. Free Trial members will also be included. We believe that Prime Pantry is an additive value to the Prime program that will drive acquisition and retention. For the premium levels of Prime, we would like to offer a better Pantry experience. For example, Prime Plus members get an additional free 50lb Pantry box with each one they purchase for \$5.99. For Prime Fresh members our intent is to make Pantry shopping experience free of any delivery charge. The details of this will be scoped with the Fresh team. Our current financial model does not yet include any costs associated with enhanced Prime benefits, nor have we taken any allocation for Prime subscription revenue.

*FAQ 7: Why are you showing Non-Prime member's selection and prices they can't attain?*

We believe that Prime Pantry is an additive value to the Prime program and one that will drive acquisition and retention. By showing selection and savings, we are incentivizing non-Prime members to join the Prime program and take advantage of our offerings. In the consumables world, customers are habituated to see "Member only" pricing. E.g. Costco advertises its discounted prices to all customers but only members can buy.

*FAQ 8: Why not charge an annual subscription fee, like a Costco?*

As long as we use parcel delivery services that charge on a per-weight basis, we need to have order weight shipping fees to create guardrails on the order economics. As we develop delivery systems with per-stop based costs, we may be able to offer simpler annual fee models. For example, we may be able to deliver Prime Pantry to Prime Fresh members for no additional fees.

*FAQ 9: Why not add a subscription/auto-delivery component?*

We know that subscriptions generate loyalty and are important to the customer experience of ordering staples – repeat purchases. We will enable customers to set auto delivery. During subscription set up, we will be completely transparent to the customer that we can stop carrying the product anytime. However, customers will be given a choice to continue their subscription with a product substitute, if available, or stop the subscription entirely. We will also make it very easy to order from "My Past Purchases," similar to AmazonFresh and Quidsi.

*FAQ 10: Have you considered adding FBA?*

We know that hybrid models always offer more value to our customers. We will consider adding FBA merchants to participate in Prime Pantry if they can offer the price Pantry customers will grow accustomed to.

*FAQ 11: Does the Prime Pantry compete with AmazonFresh?*

No. This format will compliment AmazonFresh. In fact, we can envision Prime Pantry orders being delivered by AmazonFresh trucks – probably without any weight thresholds since our Fresh trans economics are driven per-stop instead of per-pound. The AmazonFresh truck will bring both the supermarket order (Fresh) and the club order (Prime Pantry).

*FAQ 12: Does the Prime Pantry compete with Subscribe and Save?*

No. If an ASIN can be profitably sold via Subscribe and Save, we will keep it in Subscribe and Save. The Prime Pantry will sell the items we cannot profitably sell via Subscribe and Save, particularly low-ASP items, low-value heavy items, and head CPG selection price matched to offline retail formats.

*FAQ 13: Have you considered adding selection beyond Consumables?*

So far, we have been focused on how to make the Consumables selection work without the positive impact of carrying higher margin selection from other categories. Once we validate the approach, we will move quickly towards defining the long term approach for adding selection.

*FAQ 14: What technical primitives will this initiative deliver that other businesses could innovate with?*

The technical primitives we will build include showing customers localized inventory, inline cart, add to cart from search and browse, calculating weight based shipping and buying from past purchases. All these features will be extensible to other use cases on Amazon.com and our preliminary research shows that other business teams are researching and creating similar features. Location based Inventory impacts both Prime Fresh and Prime Plus launch. RCX is currently researching building an in-line cart for use cases such as gift cards and wireless and will work with Pantry to design and test the approach. Calculating shipping charge by weight could impact bulk ordering with B2B while easy ordering from past purchases can be rolled out site wide. We will focus on building scalable features and continue to reach out to teams and combine resources when applicable.

*FAQ 15: How does the Pantry Store work with Prime Plus and Prime Fresh?*

Prime is launching a few variations of Prime in 2013 and will continue to do so in the future. We plan to open the Pantry store to all Prime members regardless of plan or stage as we believe that the Pantry Store will add value to the Prime program and will drive acquisition and retention. For the premium levels of Prime, we will offer a better delivery experience. For Prime Plus members, the delivery SLA will be the same as the overall Pantry Store but they will get their 50 pound box for a discounted fee (TBD). Prime Fresh customers will be subjected to Fresh order minimums and the \$5.99 Pantry charge will be waved entirely as we use last mile options for delivery. The current financial model does not yet include any costs associated with enhanced Prime benefits, nor have we taken any allocation for Prime subscription revenue. Our next step is to build individual order economics for these new Prime plans.

*FAQ 16: How do Pantry ASINs compare to existing selection on Amazon and will Pantry ASINs cause any distrust in Amazon Pricing?*

The Pantry store will offer value through lowest prices, pack size and availability. The following table shows items in a typical Pantry order, and compares Pantry price/pack size to Costco in-store, and Amazon.com. In this sample set, our current pricing on Amazon.com is higher than Costco in-store prices. Pantry will allow us to compete with the Club channel prices, and will offer unique selection that is currently unavailable on Amazon.com. For instances where there is overlap in selection, Pantry will match Amazon.com or competitor on a per unit basis, whichever is lower. If we are matched to Amazon.com, we will offer value in our pack size. Pantry will actually reinforce trust as a comprehensive shopping destination by offering Prime members prices and selection that are not available today.

*FAQ17: Why is a national launch important?*

We need volume to make vendors interested in giving us the Product COGs that are at the base of this business model. As an example, our anticipated first year national Pantry volume with Procter and Gamble is 8.1% of their 2012 COGs on Amazon.com. While we anticipate vendors being excited to partner on a new model, material volume reductions will endanger this participation.

*FAQ 18: Why would we invest in a business with low/breakeven NPV?*

The long-term benefits of Pantry must be evaluated beyond the NPV modeled for this initiative. Building a CX that supports high unit orders of frequently purchased items and an operational model that profitably fulfills low ASP consumables will create a framework that can scale across other consumer businesses. Additionally, we will create a business that can directly (and fairly) compete with the Club channel on price, and reduce customer's trips to competitors. We have modeled 2018 Pantry revenue of \$2.9B. The financial packet shows that if there is a +5% incremental lift on (non-pantry purchases) we will increase OPS by \$TK and Operating Profit by \$TK—the impact of this business is difficult to predict, but the potential upside is very high. (See Financial Packet)

*FAQ 19: What is the launch date for the Pantry Store?*

We estimate a launch date of 2/26/2014. This launch date misses the original S-team goal of 12/31/2013. We plan to complete and Beta test all core development work by October. During code freeze we will build secondary features and use 8 weeks of the New Year (post code freeze) for deploying fixes and end to end product testing.