

Amazon.com

Investment view

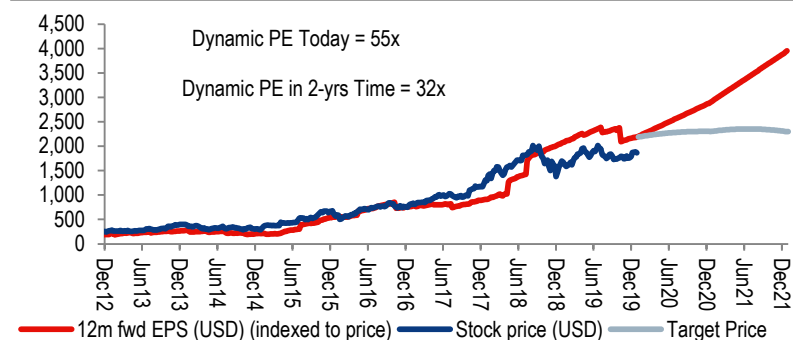
Amazon's strong revenue growth has been a key highlight over 2019, however, following its 3Q19 result (24 October), the market responded negatively to softer than expected 4Q19 profit guidance. AMZN's lower profit guidance was actually a positive because it reflected Amazon's commitment to increase short term costs (adding salespeople and promoting 1-day shipping) to maintain strong sales growth, strengthening AMZN's online/logistics competitive advantage. In our view, Amazon offers excellent value under US\$2,100 and, having underperformed its global peers and the broader market over the past couple of years, Amazon enters 2020 as one of our top picks for the year ahead.

Amazon's business model, developed in the US, is now readied for rapid global expansion and dominance. The formation of the Amazon Prime membership helped Amazon build a unique warehousing/logistics competitive advantage in the US, which it is now using to expand its online offering internationally and to help accelerate its SVOD (subscription video on demand) service through Amazon Prime Video. Amazon's philosophy centres on delivering a great consumer experience and expanding this across as many categories as is practicably possible, first in the US, then internationally where feasible.

Amazon's operations include:

- Online retail sales platform and associated logistic operations, providing cloud storage, developing electronic devices and creating media content. Amazon has a large fulfilment centre footprint which creates a large barrier to entry for competitors. This helps Amazon quality-control freight commitments between suppliers and its Amazon Prime members.
- Amazon's Prime Eligible memberships (annual subscriptions cost >US\$100) continue to accelerate and are estimated to have hit >60% of the US addressable market. Memberships are also offered globally and in time should enhance earnings from outside the US market.
- Amazon Prime Video, its SVOD service, is estimated to have reached more than 100m viewers globally (>60m in the US) by the end of 2019. Heading into 2020, Amazon has committed to doubling its investment in original content over the next few years, which should help to grow viewership subscriptions.
- The Amazon Web Services (AWS) cloud-computing platform has been a source of profit surprise and valuation upgrades in recent years. We expect AWS to be an ongoing source of rapid growth.

Figure 1. Share price and EPS (with dynamic PE)



	Mkt Cap (USDbn)	Price (USD)	12-mth Chg	FY19 PE	FY20 PE	PEG	ROE	Div yld
AMZN	924.5	\$1,864.72	+9.9%	66.6x	48.3x	1.9x	24%	0.0%

Source: Forsyth Barr analysis, Bloomberg



Sector: Consumer Discretionary, Internet Retail

Ticker code	AMZN
Exchange	NASDAQ
Benchmark index	S&P 500 INDEX
Currency	USD
Next balance date	12/2019

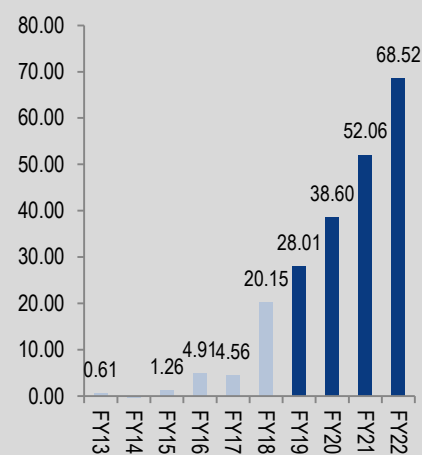
Source: Forsyth Barr analysis

Share price performance (USD)



Source: Forsyth Barr analysis, Bloomberg

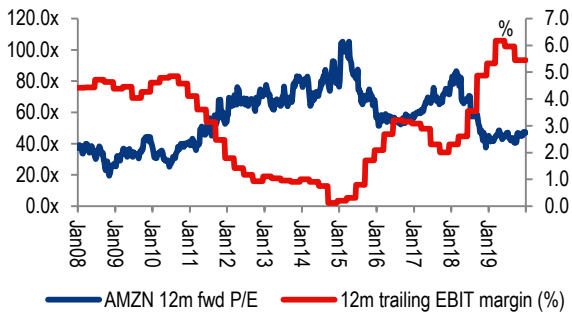
EPS (USD)



Source: Forsyth Barr analysis, Bloomberg

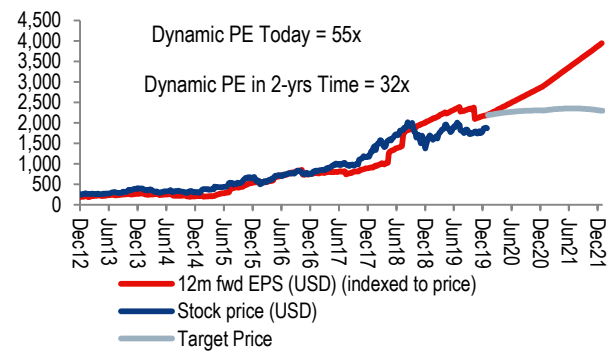
Key metrics: Amazon.com

Figure 2. EBIT margin and PE ratio



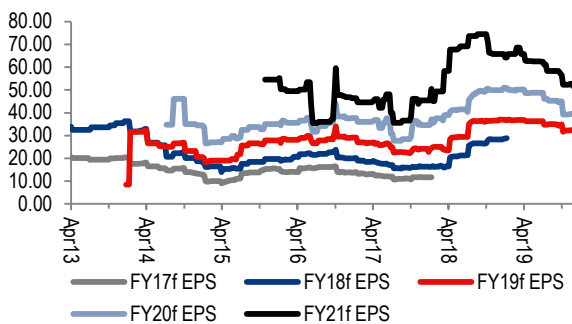
Source: Forsyth Barr analysis, Bloomberg

Figure 3. Share price and EPS



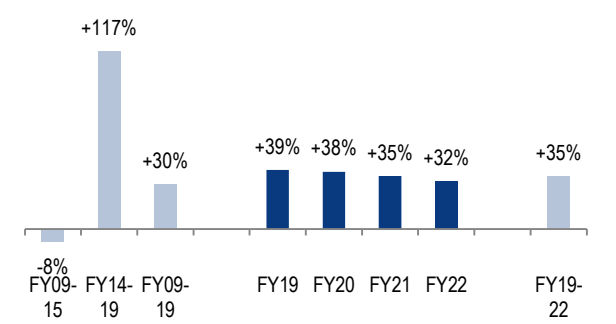
Source: Forsyth Barr analysis, Bloomberg

Figure 4. Evolution over time of EPS forecasts by fiscal year



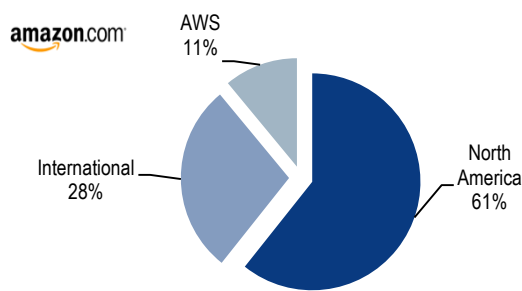
Source: Forsyth Barr analysis, Bloomberg

Figure 5. Historical and consensus forecast EPS growth



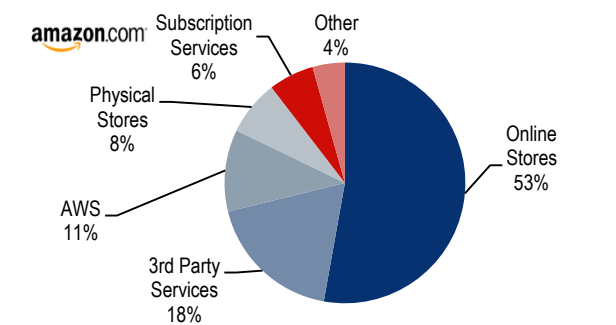
Source: Forsyth Barr analysis, Bloomberg

Figure 6. Revenue by region



Source: Forsyth Barr analysis, Company data

Figure 7. Total revenue (per segment) (US\$bn)



Source: Forsyth Barr analysis, Company data

Our "Dynamic PE" is a guide to the multiple we believe is an appropriate 12-month forecast PE based on historic trends and taking into account the stock's medium-term growth prospects and cost of capital.

Fact sheet: Amazon.com



Company information

Industry	Internet
Founded	5 July, 1995
Listed	15 May, 1997
Founders	Jeff Bezos
Headquarters	Seattle, Washington, USA
Geographical exposure	Global
Key people	Jeff Bezos (CEO), Brian Olsavsky (CFO)
Employees	566,000
Alexa rank	13 (January, 2020)
Revenue	US\$177.9bn (FY18)
Net income	US\$3.0bn (FY18)
Total Assets	US\$131.3bn (FY18)
Total equity	US\$27.7bn (FY18)
Website	www.amazon.com

Top Shareholders	%
Bezos Jeffrey P	11.61
Vanguard Group	6.40
Blackrock	5.34
Bezos Mackenzie	3.99
State Street Corp	3.37

Source: Forsyth Barr analysis, Wikipedia, Bloomberg

Background

- In 1994 Jeff Bezos quit his job to work on a business plan that would take advantage of the internet business boom. On 5 July 1994, he set up an online book retailer in the garage of his property which would soon become Amazon. A year later the company sold its first book online, and after just two months of business it had sold books to all 50 US states and over 45 different countries.
- From 1998 the business expanded its offerings beyond just books. In 2000 it launched its third party market place. A few more key introductions for Amazon were the launch of the Amazon Web Services (AWS) cloud service in 2002, the launch of Amazon Prime memberships in 2005, the introduction of Amazon Fresh in 2010, and the global roll out of Amazon Prime Video in 2016.

Business description

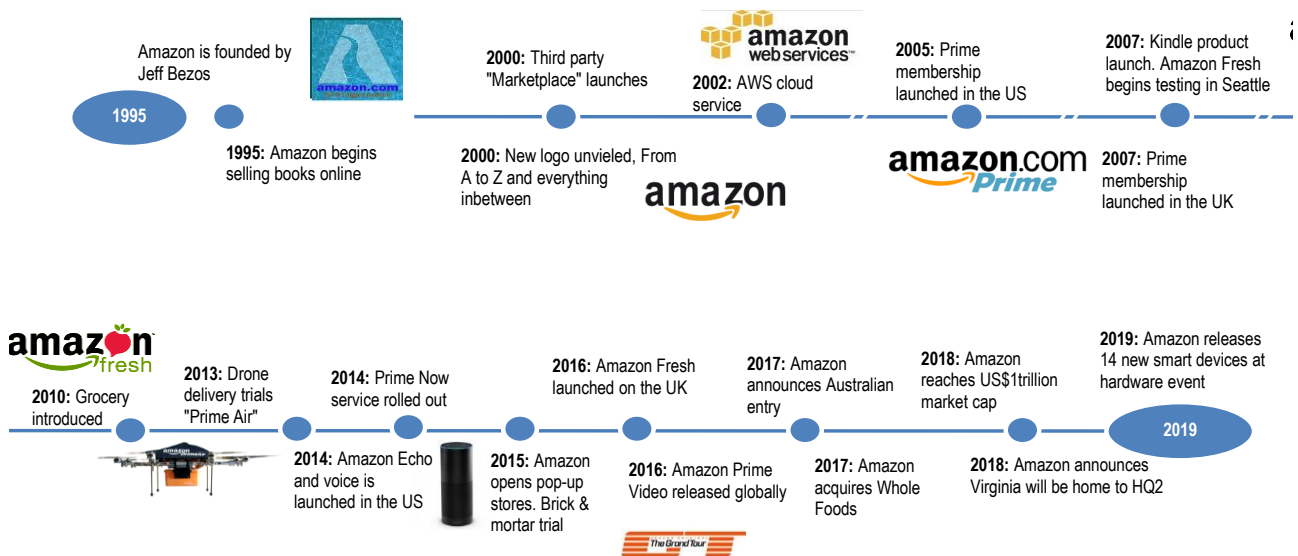
- Amazon is the largest internet-based retailer in the United States and one of the world's largest e-commerce businesses.
- Amazon operates a number of business segments across the globe (although North America remains its core geographical segment). There are five key revenue generating segments:
 - **Online Stores** remains the company's largest contributor to revenue. It focusses on the sale of Amazon manufactured or sourced products. Also included in this segment are the company's popular consumer electronic products such as Kindle, Fire tablets and Echo Home Systems.
 - Amazon also provides a platform for **Third-Party Selling** for which it charges fees for listing products and for extras like advertising to help sellers reach more consumers.
 - **Amazon Web Services (AWS)** is Amazon's fastest growing segment and is focussed on selling platform-as-a-service and infrastructure-as-a-service products. The range of products it provides within this segment is ever expanding.
 - **Subscription Services** is another fast growing segment. It generates revenue from selling Amazon Prime memberships, which give users access to audiobook, digital video, e-book, digital music and other non-AWS subscription services.
 - Despite being an online retailer, Amazon has a number of **Physical Stores**, mostly thanks to its acquisition of supermarket chain Wholefoods in August 2017.
- Amazon's business model and services are constantly growing as it continues to heavily invest in ways to both enter new business segments and to develop its current services, such as its efforts to become the first online retailer to successfully release a "less than 30 minutes" delivery system via the use of drones (Prime Air).

Amazon — The King of Retail

Amazon is the world's largest e-commerce company, as well as being the largest global cloud computing provider in the Infrastructure-as-a-Service (IaaS) space through its Amazon Web Services (AWS) offering.

Amazon.com was first launched in 1995 as an online book store. Since then, Amazon has expanded from selling books to selling just about anything, providing sales and fulfilment for other retailers, undertaking logistics, providing entertainment and cloud hosting services, and developing electronic gadgets and artificial intelligence-driven software. Amazon has grown so large so quickly that legal scholars have suggested regulators re-write antitrust laws to promote competition and improve data protection.

Figure 8. Brief history of Amazon



Source: Forsyth Barr analysis, Amazon

Amazon's strategy is to be the most customer-centric company and is guided by four principles: (i) customer obsession rather than competitor focus, (ii) passion for invention, (iii) commitment to operational excellence, and (iv) long-term thinking. Amazon is a champion of efficiency, often at the expense of industry incumbents, as it passes cost benefits on to customers.

These principles have led Amazon to establish itself as a market leader in various industries, most notably:

- Retail:** Amazon is first and foremost an online retailer, with its origins still the cornerstone of its business today. The e-commerce Marketplace is the world's largest, with ~50% of every dollar spent online in the US going through Amazon.com. The company operates as both a direct seller of goods and as a platform for third-party sellers to distribute their products. Amazon has also successfully launched its own private label products on the back of merchant data.

Amazon Prime is a subscription based service that gives users access to a bundle of benefits offered across Amazon's platform. The premium offering varies in quality and cost by country and region but the basic benefits include free two-day shipping, streaming video/music, preferential access to specials, and unlimited photo storage. The Prime service has already attracted 145 million users globally who each pay an annual fee in excess of USD100.

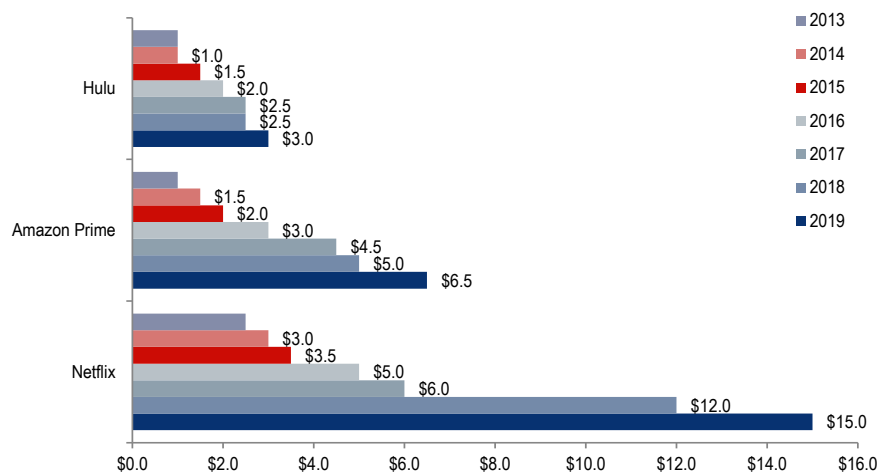
Amazon's latest retail experiment is with convenience stores that don't have a checkout — just load the Amazon Go app, swipe your phone as you enter the store, grab what you want and walk out. The store's cameras and artificial intelligence systems work out what you've added to your bag and charge it to your account. Whether Amazon extends this model to the brick-and-mortar supermarket chain it bought in 2017, Whole Foods Market, remains to be seen.

- Logistics:** Reliable and speedy delivery is an important competitive edge for Amazon. As an online retailer, Amazon competes against the instant gratification offered by purchasing from traditional retailers; the faster the delivery, the smaller that gap becomes. Amazon has created one of the most advanced fulfilment networks globally and since 2006 has been leveraging that scale by selling fulfilment to third parties. The Fulfilment By Amazon service (FBA) stores, packs, and ships for brands and retailers selling on its site. For a product to be Prime eligible it is usually required to be FBA, as Amazon eliminates delivery quality risk by reducing reliance on external logistics providers, while also spreading inventory across Amazon’s extensive fulfilment warehousing network to speed up delivery times. In 4Q19 alone, Amazon invested \$1.5bn in its one-day shipping initiative.
- Content/media:** Amazon Video is a subscription video on demand (SVOD) service that offers subscribers access to a large library of television shows and films for users to stream online and is included as part of the Amazon Prime subscription. Amazon is investing heavily (US\$5bn) in original content, currently outspent only by Netflix (US\$12bn). By comparison, HBO is estimated to have spent US\$2.5bn in 2018. During 2019, Amazon teamed with Sinclair Broadcast, Blackstone and the New York Yankees to buy the YES Network, further extending its media reach.

In 2019, US media and entertainment companies spent in excess of US\$120m on original content of which five companies made up 72% (US\$88m) of this spend: HBO (owned by AT&T), ViacomCBS, Netflix, Comcast and Disney. Looking forward, we expect Amazon Prime Video and Apple to implement content strategies to move up into this “Group of Five”.

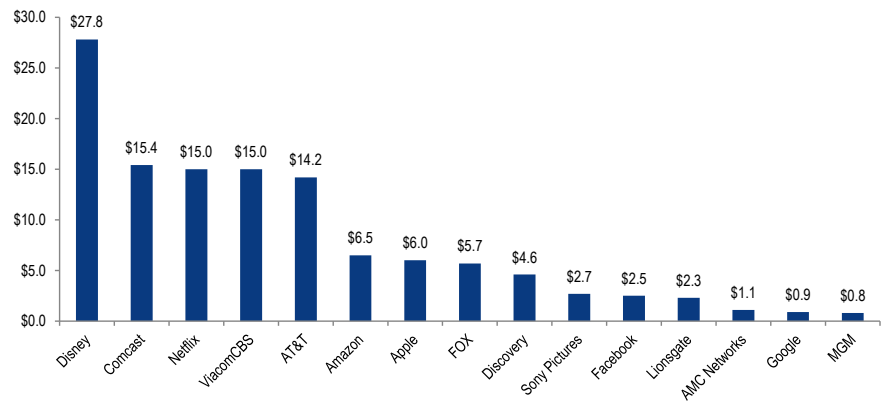
The race for SVOD dominance intensified in the 2H19 (launch of Disney+ and Apple+). In September 2019, ResearchAndMarkets forecast global SVOD subscribers will increase by 91% to 970 million by 2024 (up +462 million subscribers since 2018). By 2024, the report projects that four companies will control 45% of the global total namely: Netflix (23%), Amazon Prime Video (13%), Disney+ (8%) and Apple+ (at just 1%). We believe the projections for Amazon Prime Video, Disney+ and Apple+ may turn out to be far too conservative, given the commitment and increasing size of the content budget from these three emerging SVOD services.

Figure 9. Content spend by Hulu, Amazon Prime, Netflix (US\$bn)



Source: Forsyth Barr analysis

Figure 10. 2019 content spend by major media Companies (US\$bn)

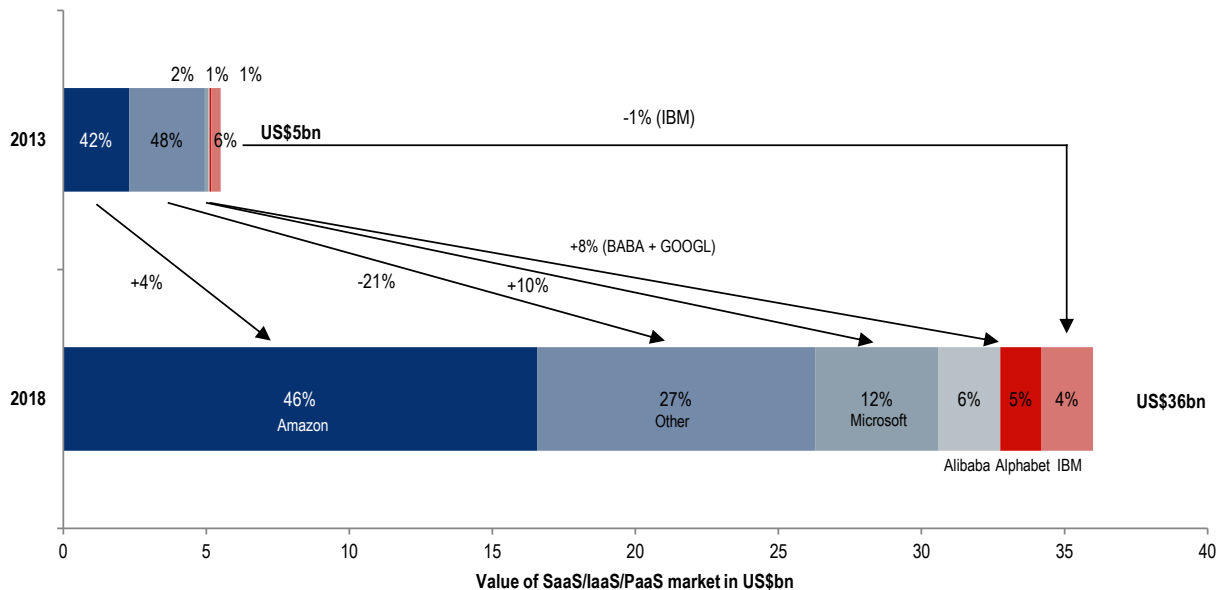


Source: Variety.com

Amazon’s media ambitions aren’t only limited to video and the service includes a number of ancillary benefits such as:

- Prime Music: With an extensive library, Prime Music is a music streaming service. Music Unlimited is an upgraded version of Prime Music and is available for an additional monthly fee. Subscribers gain access to a library of tens of millions of songs, ad-free, with downloadable content for offline listening.
- Twitch Prime: Twitch is a video streaming platform that focusses on video gaming, including gameplay walk through, broadcasting of e-sports, and creative content. Twitch also provides gamers with additional bonus downloadable content.
- Audible: With Audible customers can download/stream audiobooks and podcasts.
- **Cloud services:** Amazon Web Services (AWS) pioneered the cloud Infrastructure-as-a-Service (IaaS) market and subsequently started providing services within the Platform-as-a-Service (PaaS) market. AWS offers a broad and ever-expanding range of computing, storage database, analytics, application and deployment services. Amazon has solidified its position as the leading cloud services provider, with 46% market share in the SaaS market in 2018, up from 42% in 2013, despite an increasingly competitive environment.

Figure 11. Market value of SaaS/IaaS/PaaS market

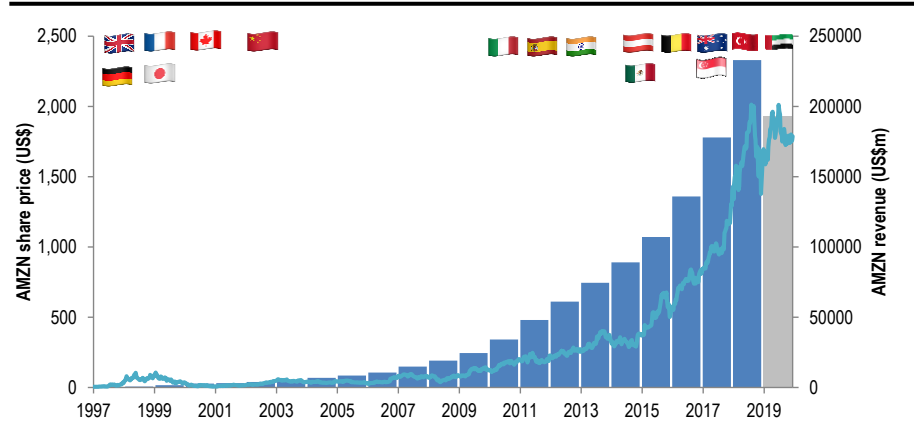


Source: Forsyth Barr analysis

- Technology innovation:** Amazon utilises technology throughout its value chain to drive efficiency. For example: Amazon uses robots in its fulfilment centres, is testing drones to undertake deliveries, and is using cameras and artificial intelligence systems in its checkout-less convenience stores. Amazon also develops its own hardware devices such as: Fire Tablets, Fire TV, Echo and Alexa, Kindle E-readers. Amazon has also made major investments in autonomous driving.

After 25 years of doing business, Amazon has ~650,000 employees, occupies 288.4 million square feet of real estate, and accounts for half of online retail in the United States. Amazon has taken a long term approach to investment, often choosing to forgo near term profits in favour of long-term customer loyalty and future opportunities. Since 1997, Amazon has grown revenue at a CAGR in excess of +40%. Although bottom line growth has been far patchier, for the last four years Amazon has consistently turned a profit.

Figure 12. Amazon's share price, revenue, and entry into foreign markets



Source: Forsyth Barr analysis, Amazon

The shift from bricks and mortar to online shopping has now been underway for two decades and looks set to continue for a long time yet. Broad product ranges, tools to help choose, customisation, convenience, great service and cost/price advantages will continue to draw more consumption online. Amazon looks expensive on a P/E multiple basis, partly due to its high rate of reinvestment in growth, which depresses earnings in the short-term. The valuation looks more tolerable if one adjusts earnings upwards on the assumption that Amazon will soon shift from targeting world domination towards harvesting earnings.

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