



## **ANALYST QUICK NOTES**

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**Amazon.com Inc. (NGS: AMZN: BUY)**

**Target Price: \$935**

**Jim Kelleher, CFA**

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### **Amazon: Multiple routes to margin expansion**

- AMZN has significant growth potential as it continues to conquer new markets and extend its dominance in existing markets.
- While valuation has been challenging, we think value in the company is growing faster than the stock price.

### **Unmatched growth in eCommerce and IaaS**

- On 9/21/16, we raised AMZN to BUY with a \$935 target price.
- Despite its massive size, AMZN is growing like a start-up.
- 3Q16 revenue grew 29% to \$32.7 billion, with 20%-plus annual growth in both domestic and overseas retail.
- AWS grew 55% year/year.

### **4Q16 outlook (on or about 1/27/17)**

- Street: revenue of \$44.7 billion, Non-GAAP EPS of \$1.36.
- Argus: revenue of \$44.9 billion, Non-GAAP EPS of \$1.55.
  - At Argus estimate: NG EPS down 15%, revenue up 26%.
- In 1Q17, Street sees return to positive EPS comps (\$1.69 vs. \$1.07 year earlier).

### **Amazon: Master of new strategies to dominate markets**

- Echo & Alexa: Android Authority, Tech Times, Finance Yahoo and other media outlets called Alexa the star of CES 2017.
  - Alexa voice assistant moving beyond Echo (cylindrical in home device) with third-party applications and companies (Hyundai, Mattel) producing Alexa-compatible vehicles, refrigerators, baby monitors, etc.
- eCommerce: Prime credit card with 5% back – today Chase and Amazon introduced Prime Rewards Visa Signature Card, with 5% back on all Amazon purchases (not just Prime).
- AWS continues to add new higher-margined services and growing with its customers as more services migrate to cloud.

### **Margin expansion key to thesis**

- We believe that AMZN is positioned for margin expansion in its retail operations...
  - ...as its fulfillment-center model matures...
  - ...and the company benefits from volume leverage driven by Prime and other differentiated online capabilities.
- Retail margins can only expand so much, and the 4%-5% level may be close to the ceiling.
- The key to margin expansion beyond retailers' levels is the growth in the high-margined AWS business.
  - AWS grew organically out of Amazon's need to support its thousands of merchants and run a complex data-management business.
  - AWS first-mover advantage in IaaS will support its move into other areas ranging across public, private and hybrid cloud.
- For 3Q16, AWS operating margin was record 31.6%, compared with...
  - ...about 4% for North American Retail and
  - -3% for International retail.
- Consolidated segment operating income (CSOI) declined sequentially to 4.2%, from 6.3% in 1H16.
  - We expect international retail to bounce back in 4Q, enabling margins to recover.
- Based on its significantly higher operating margin, AWS is on track to account for over 40% of total 2016 operating income, even though AWS accounts for only about 9%-10% of revenue.
- By 2017, based on AWS' superior growth rate, AWS could be contributing over 45% of total operating income while pushing non-GAAP operating margin and CSOI margin well above 7%.

### **Valuation has been the challenge with AMZN**

- We have long believed that AMZN should be accorded higher multiples based on its ability to consume market cap.
  - In retail: books (Borders), electronics (Circuit City), etc.
  - Now in technology, CPE servers & storage; soon, software.
- But we also want to ground our thesis in quantifiable valuation work.
- AMZN trades at a mid-20s EBITDA/Enterprise Value multiple for 2017, compared to 26-times EBITDA/EV multiples on an historical (2011-15) basis.
- Using our two- and three-stage discounted free cash flow model, we calculate a value in the \$1,300 range.
- Our blended valuation model suggests as 12-month value for Amazon above \$1,050.
- As long as AMZN keeps growing topline and expanding margins, valuation targets will push out as well.

## Conclusion

- Given the company's indisputable franchise leadership, its ability to leverage its vendor relationships in the retail space, and its market dominance and superior growth in infrastructure-as-a-service, we believe AMZN warrants long-term accumulation in most equity accounts. BUY to \$935.
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