

Amazon, one of the mega caps in the Nasdaq and SP500, has had an incredible growth journey. The post pandemic era may see a down shift in growth with an increase in free cash flow generation. How will the market value a more mature company?



Amazon: Maturity Creates Value

Amazon faces maturity: With 10% of the US retail market, sales growth in 1P and 3P as well as its prime, media and advertising segments should slow. Amazon has become the market.

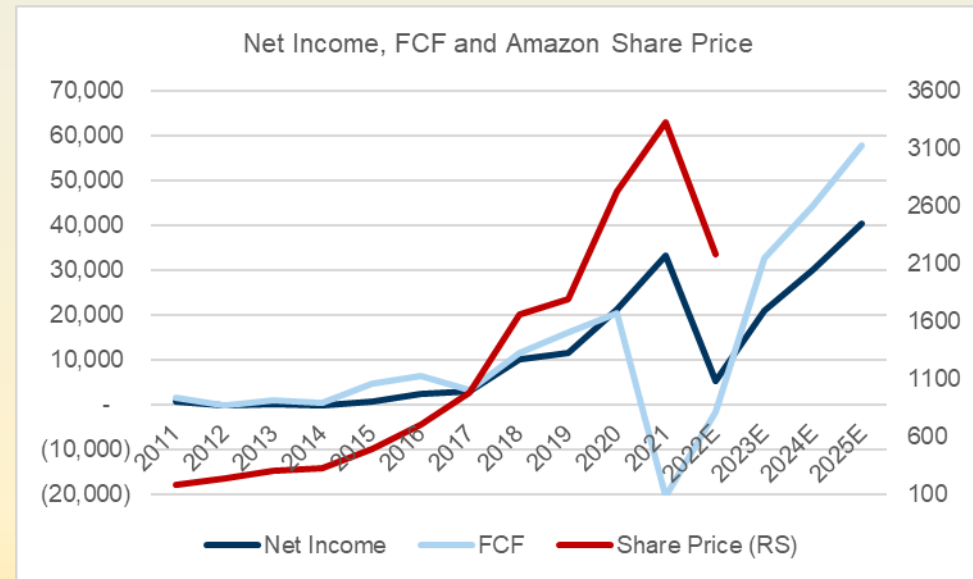
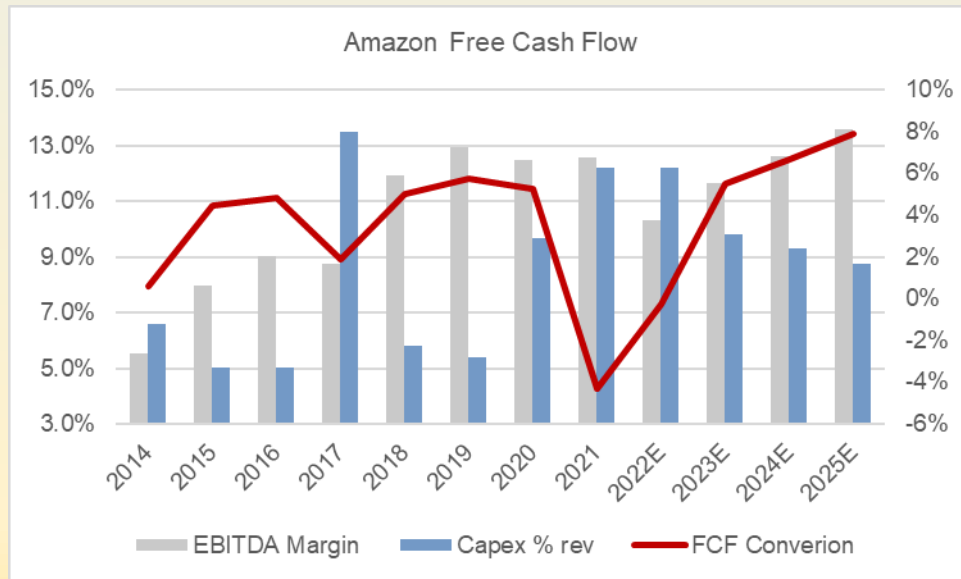
AWS also slows: Amazon Web Services is 33% of the market with heavy weight competition (Microsoft, Oracle, Google) . Growth rates of 30% do not seem sustainable and should decline to 20%.

Margin gains: Post pandemic capacity expansion and fixed cost in fulfillment should be diluted and EBITDA margins can expand from 10% to 14% through YE25.

Free Cash Flow acceleration: Slower growth has a big advantage, lower capex as well as working capital plus EBITDA margin gains can produce US\$30bn in FCF for 3% yield in YE23 and growing.

Valuation: At 15x EV/EBITDA, a significant discount to consensus (24x) provides 30% upside with a YE22 price target of US\$2,858.

Risk: Short term analyst downgrades and a still weak 2Q22 plus market dynamic, can keep the share around US\$2000 (pre split).



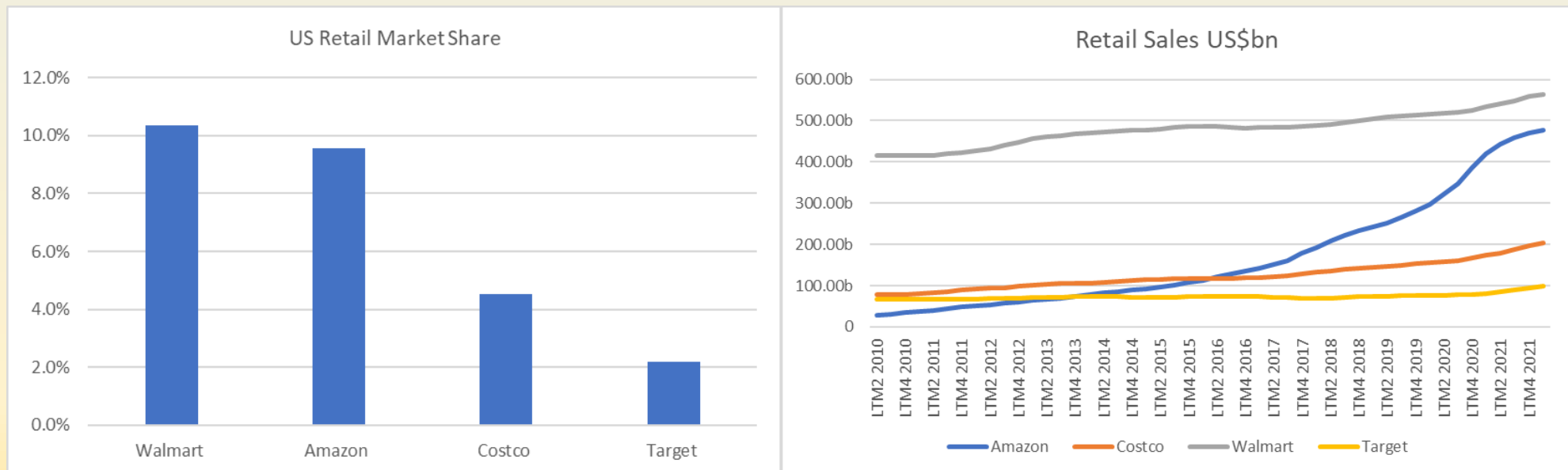
Amazon: Extraordinary growth meets maturity, what happens to valuation?

Amazon's growth story is not over but faces a slowdown with a shift toward maturity and significant free cash flow generation. **The key question is: Can Amazon keep its premium valuation as it moves into slower growth and dare I say begins to pay dividends?**

Amazon's core ecommerce sales are slowing on maturity. With an estimated 10% market share of all retail sales in the US (11% Walmart) Amazon could see better than market growth for a few years on further ecommerce penetration but sooner rather than later retail sales should slow and grow on a multiple of GDP i.e. 5%+. That leaves the cloud service business (AWS) to carry growth, and this has an estimated 33% share (Microsoft 22%) and unlikely to be able to maintain a 20%+ growth rate past YE25.

Slower revenue growth: 1- ecommerce (1P) retail sales via its website are decelerating 2- marketplace (3P) products it sells on its website for third parties should continue to grow at 2x GDP (nominal), 3- Entertainment and Marketing in line with 1P and 3P traffic generation, and prime service (Prime accounts are an estimates 125m same as US Households). 4- Cloud service, Amazon Web Service (AWS) is the key driver. Thus, on a consolidated bases Amazon looks more like a 12% top line grower medium term with a gradual decline as 1P and 3P decelerate simply due to size, Amazon is the market.

Amazon retail is a bigger than one may think. Reported marketplace (3P) revenue is the fee it charges the third-party retailers to list and deliver products and at a 20% take rate this backs into over US\$400bn in gross merchandise volume (GMV), about the size of Walmart. Add its direct sales (1P) and this adds up to US\$600bn and with 70% sales in the US, this is over US\$400bn vs total US retail sales of US\$4.5trillion.



Amazon: Can AWS offset retail and marketplace?

What is AWS? It's made up of many different cloud computing products and services such as storage, networking, remote computing, email, mobile development, and security. It's the backbone of the digital business world. AWS can be broken into three main products: EC2, Amazon's virtual machine service, Glacier, a low-cost cloud storage service, and S3, Amazon's storage system. At the heart of this business is infrastructure i.e., computer servers and software engineers, IT development and service.

Web infrastructure is a US\$350bn market that should continue to growth 20%+ year, it's akin to an electricity grid or a cable/telecom network, but at some point, infrastructure needs are met, and growth slows. They compete with Google, Microsoft, Oracle, and others.

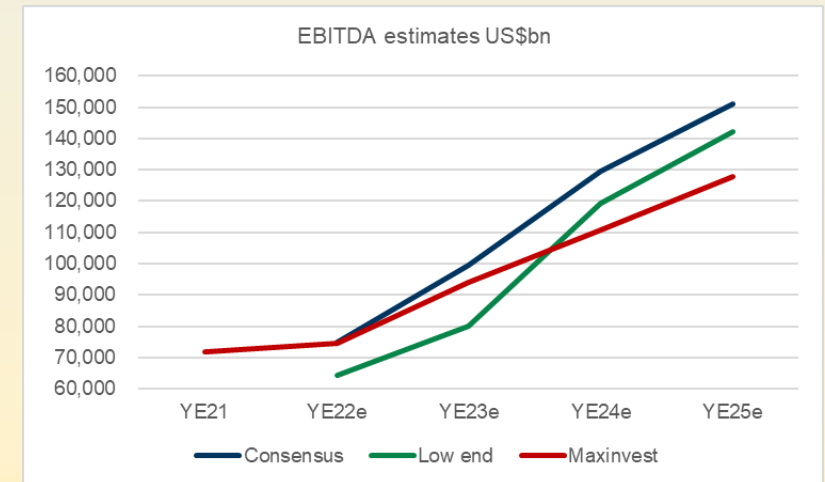
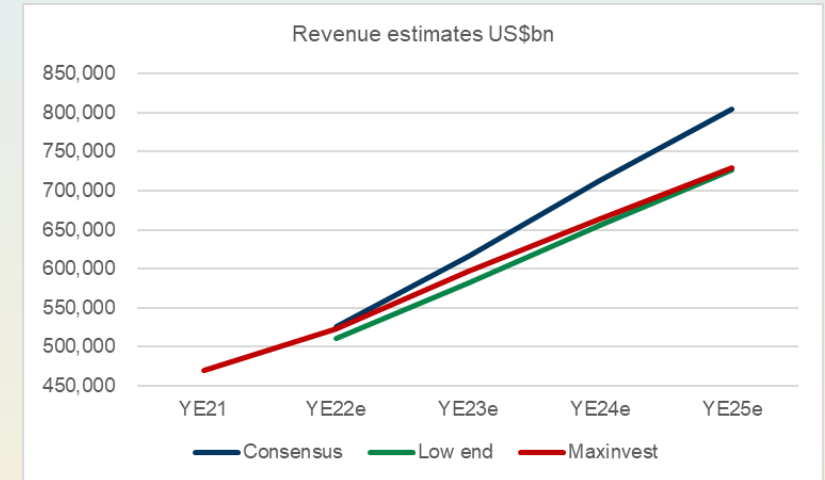
Amazon US\$m	2016	2017	2018	2019	2020	2021	2022E	2023E	2024E	2025E
Total Revenue	135,987	177,866	232,887	280,522	386,064	469,822	523,174	596,931	664,449	729,261
Online Stores	91,432	108,355	122,987	141,247	197,349	222,075	232,606	256,377	276,888	296,270
Physical Stores		5,798	17,224	17,192	16,224	17,075	18,005	18,455	18,824	19,200
Retail Third-Party Seller Services	22,992	31,880	42,745	53,761	80,437	103,366	117,133	134,703	152,214	167,436
Retail Subscription Services	6,393	9,722	14,167	19,210	25,207	31,768	36,238	41,673	45,841	49,508
Advertising Services					19,921	31,160	36,381	41,838	46,022	49,704
AWS	12,219	17,458	25,656	35,026	45,370	62,202	79,920	100,269	120,323	141,981
Revenue Breakdown	2016	2017	2018	2019	2020	2021	2022E	2023E	2024E	2025E
Online Stores	67%	61%	53%	50%	51%	47%	44%	43%	42%	41%
Physical Stores	0%	3%	7%	6%	4%	4%	3%	3%	3%	3%
Retail Third-Party Seller Services	17%	18%	18%	19%	21%	22%	22%	23%	23%	23%
Retail Subscription Services	5%	5%	6%	7%	7%	7%	7%	7%	7%	7%
Advertising Services	0%	0%	0%	0%	5%	7%	7%	7%	7%	7%
AWS	9%	10%	11%	12%	12%	13%	15%	17%	18%	19%
Growth	2017	2018	2019	2020	2021	2022E	2023E	2024E	2025E	
Revenue Consolidated	31%	31%	20%	38%	22%	11%	14%	11%	10%	
Online Stores	19%	14%	15%	40%	13%	5%	10%	8%	7%	
Physical Stores		197%	0%	-6%	5%	5%	2%	2%	2%	
Retail Third-Party Seller Services	39%	34%	26%	50%	29%	13%	15%	13%	10%	
Retail Subscription Services	52%	46%	36%	31%	26%	14%	15%	10%	8%	
Advertising Services					56%	17%	15%	10%	8%	
AWS	43%	47%	37%	30%	37%	28%	25%	20%	18%	
Amazon US\$m	2016	2017	2018	2019	2020	2021	2022E	2023E	2024E	2025E
Total Revenue	135,987	177,866	232,887	280,522	386,064	469,822	523,174	596,931	664,449	729,261
YoY		31%	31%	20%	38%	22%	11%	14%	11%	10%

Amazon: Mega cap peers compete on growth and valuation

Consensus Forecast too positive? There are 48 analyst covering Amazon with consensus estimates that point to a still high 14% revenue growth, 25% earnings growth, FCF of US\$40bn and a YE22 price target of \$3700 or an implied PE of 66x and EV/EBITDA of 25x. EBITDA margins are forecast to increase to 19% and cash to build up to over US\$150bn by YE25 a very positive scenario.

The low end of estimates does not change much, which prompts me to believe the market could be enthralled with Amazon and perhaps not applying a potential slowdown risk that, in my view, is a very real possibility.

Consensus YE22	Walmart	Target	Amazon	Alphabet	Microsoft	Apple
Sector	Retail	Retail	Retail/Tech	Tech Media	Tech Software	Tech Hardware
Mkt Cap US\$bn	415	103	1,124	1,490	1,981	2,541
EV/EBITDA	12.2	9.8	15.8	11.4	18.5	19.0
EBITDA Growth	4%	0%	4%	14%	21%	9%
EBITDA Growth 3yr	6%	2%	26%	16%	20%	5%
EBITDA Margin	6%	11%	12%	36%	49%	34%
FCF Conversion	3%	5%	3%	24%	22%	27%
FCF Yld	4%	5%	1%	5%	3%	4%
FCF Yld YE24	4%	7%	6%	7%	4%	5%
Consensus PT	166	273	3684	3280	364	189
Upside	10%	22%	69%	45%	37%	20%
Implied EV/EBITDA	13.0	11.8	24.9	16.6	26.9	22.8



Amazon: Downgrade Valuation Multiples

I believe Amazon shares may continue to trade sideways until at least 3Q22. This is partly due to market dynamics, Fed rate hikes, inflation, and slower GDP growth. Partly due comparative valuations, there are a lot of very beaten down stocks with solid growth to look out for. And finally, the possibility of analyst downgrades. However, post 3Q22 and prime day, Amazon results could begin to reflect the new slower growth and higher FCF dynamics.

Negative triggers – Consensus downgrades i.e., price target cuts, reduced guidance of course and missing estimates.

Positive triggers – M&A that enhances cost structure, expands away from US or expands and creates new vertical i.e., logistics, fintech or software.

Would share buy backs and a dividend add value to the stock? Theoretically yes but many would view this as a sign of maturity, slower growth, and an inability to find new ideas. This could backfire and lead to lower valuation.

On more conservative estimate, one that assumes Amazon's core ecommerce platform slows revenue growth to 12% and margins expand to 13.6%, EBITDA grows 20% and cash build up to US\$100bn. Still very good results for a company the size of many nations. At a 15x EV/EBITDA target multiple, Amazon has 30% upside, in my view.

Amazon	YE21	YE22e	YE23e	YE24e	YE25e
Share Price	3,500	2,200	2,200	2,200	2,200
Shares Out	505	512	518	524	531
Mkt Cap	1,768,978	1,125,765	1,139,088	1,153,241	1,167,533
Net debt	(47,305)	(36,723)	(69,517)	(113,946)	(171,676)
Enterprise Value	1,721,673	1,089,042	1,069,571	1,039,295	995,857
Key Ratios					
PE	53.02	209.73	54.51	38.32	28.84
EV/EBITDA	23.93	14.62	11.38	9.39	7.79
P/Rev	3.77	2.15	1.91	1.74	1.60
FCF Yld	-1%	0%	3%	4%	5%
Growth		YE22e	YE23e	YE24e	YE25e
Revenue		11%	14%	11%	10%
EBITDA		4%	26%	18%	16%
EPS		-84%	285%	42%	33%
Financials US\$m					
Revenue	469,822	523,174	596,931	664,449	729,261
EBITDA	71,932	74,501	94,025	110,649	127,829
Margin	15.3%	14.2%	15.8%	16.7%	17.5%
Net Income	33,364	5,368	20,898	30,095	40,488
EPS	66.0	10.5	40.4	57.4	76.3
Free Cash Flow	(20,394)	(1,494)	32,794	44,429	57,730
Valuation		YE22e	YE23e	YE24e	
EV/EBITDA		15	15	15	
Price Target		2,858	3,384	3,937	
Upside		30%	54%	79%	

Amazon US\$m	2018	2019	2020	2021	2022E	2023E	2024E	2025E
Total Revenue	232,887	280,522	386,064	469,822	523,174	596,931	664,449	729,261
YoY	31%	20%	38%	22%	11%	14%	11%	10%
<i>Total Cost of Sales (ex SBC)</i>	<i>(139,156)</i>	<i>(165,536)</i>	<i>(233,307)</i>	<i>(272,344)</i>	<i>(304,917)</i>	<i>(344,900)</i>	<i>(380,582)</i>	<i>(414,050)</i>
<i>GAAP Gross Profit</i>	<i>93,731</i>	<i>114,986</i>	<i>152,757</i>	<i>197,478</i>	<i>218,257</i>	<i>252,030</i>	<i>283,867</i>	<i>315,210</i>
Gross Margin (% of Revenues)	40.2%	41.0%	39.6%	42.0%	41.7%	42.2%	42.7%	43.2%
<i>Operating Expenses (ex-SBC)</i>								
<i>Fulfillment Expenses</i>	<i>(25,359)</i>	<i>(39,050)</i>	<i>(57,159)</i>	<i>(73,165)</i>	<i>(79,962)</i>	<i>(85,464)</i>	<i>(90,910)</i>	<i>(95,183)</i>
<i>% of Retail Sales (total sales less A)</i>	<i>-12.2%</i>	<i>-15.9%</i>	<i>-16.8%</i>	<i>-17.9%</i>	<i>-18.0%</i>	<i>-17.2%</i>	<i>-16.7%</i>	<i>-16.2%</i>
YoY Growth	0.0%	54.0%	46.4%	28.0%	9.3%	6.9%	6.4%	4.7%
<i>Marketing Expenses</i>	<i>(10,507)</i>	<i>(17,743)</i>	<i>(20,300)</i>	<i>(30,021)</i>	<i>(34,092)</i>	<i>(38,800)</i>	<i>(43,189)</i>	<i>(47,402)</i>
<i>% of Total Sales</i>	<i>-4.5%</i>	<i>-6.3%</i>	<i>-5.3%</i>	<i>-6.4%</i>	<i>-6.5%</i>	<i>-6.5%</i>	<i>-6.5%</i>	<i>-6.5%</i>
YoY Growth	0.0%	68.9%	14.4%	47.9%	13.6%	13.8%	11.3%	9.8%
<i>Technology & Content Expenses</i>	<i>(19,821)</i>	<i>(32,207)</i>	<i>(37,677)</i>	<i>(49,407)</i>	<i>(57,937)</i>	<i>(65,662)</i>	<i>(73,089)</i>	<i>(80,219)</i>
<i>% of Total Sales</i>	<i>-8.5%</i>	<i>-11.5%</i>	<i>-9.8%</i>	<i>-10.5%</i>	<i>-11.1%</i>	<i>-11.0%</i>	<i>-11.0%</i>	<i>-11.0%</i>
YoY Growth	0.0%	62.5%	17.0%	31.1%	17.3%	13.3%	11.3%	9.8%
<i>G&A Expenses</i>	<i>(2,834)</i>	<i>(4,530)</i>	<i>(5,871)</i>	<i>(7,727)</i>	<i>(9,860)</i>	<i>(10,745)</i>	<i>(11,960)</i>	<i>(13,127)</i>
<i>% of Total Sales</i>	<i>-1.2%</i>	<i>-1.6%</i>	<i>-1.5%</i>	<i>-1.6%</i>	<i>-1.9%</i>	<i>-1.8%</i>	<i>-1.8%</i>	<i>-1.8%</i>
YoY Growth	0.0%	59.8%	29.6%	31.6%	27.6%	9.0%	11.3%	9.8%
<i>Total Operating Expenses (Non-GA)</i>	<i>(58,521)</i>	<i>(93,530)</i>	<i>(121,007)</i>	<i>(160,320)</i>	<i>(181,852)</i>	<i>(200,672)</i>	<i>(219,149)</i>	<i>(235,930)</i>
<i>% of Total Sales</i>	<i>-25.1%</i>	<i>-33.3%</i>	<i>-31.3%</i>	<i>-34.1%</i>	<i>-34.8%</i>	<i>-33.6%</i>	<i>-33.0%</i>	<i>-32.4%</i>
YoY Growth	0.0%	59.8%	29.4%	32.5%	13.4%	10.3%	9.2%	7.7%
<i>Non-GAAP Operating Income (CSC)</i>	<i>14,962</i>	<i>21,605</i>	<i>32,033</i>	<i>37,698</i>	<i>37,061</i>	<i>52,101</i>	<i>65,537</i>	<i>80,171</i>
<i>Operating Income Margin %</i>	<i>6.4%</i>	<i>7.7%</i>	<i>8.3%</i>	<i>8.0%</i>	<i>7.1%</i>	<i>8.7%</i>	<i>9.9%</i>	<i>11.0%</i>
YoY Growth	0.0%	44.4%	48.3%	17.7%	-1.7%	40.6%	25.8%	22.3%
<i>Stock-Based Comp</i>	<i>(5,418)</i>	<i>(6,864)</i>	<i>(9,208)</i>	<i>(12,757)</i>	<i>(20,565)</i>	<i>(24,471)</i>	<i>(26,679)</i>	<i>(28,669)</i>
<i>% of Total Sales</i>	<i>-2.3%</i>	<i>-2.4%</i>	<i>-2.4%</i>	<i>-2.7%</i>	<i>-3.9%</i>	<i>-4.1%</i>	<i>-4.0%</i>	<i>-3.9%</i>
YoY Growth	28.6%	26.7%	34.1%	38.5%	61.2%	19.0%	9.0%	7.5%
<i>Other operating income (expenses)</i>	<i>(297)</i>	<i>(201)</i>	<i>74</i>	<i>(62)</i>	<i>(249)</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>% of Sales</i>	<i>-0.1%</i>	<i>-0.1%</i>	<i>0.0%</i>	<i>0.0%</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>
YoY Growth	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
<i>Total Operating Expense (GAAP)</i>	<i>(81,311)</i>	<i>(100,446)</i>	<i>(129,858)</i>	<i>(172,599)</i>	<i>(202,010)</i>	<i>(224,400)</i>	<i>(245,009)</i>	<i>(263,708)</i>
<i>% of Total Sales</i>	<i>0.0%</i>	<i>-35.8%</i>	<i>-33.6%</i>	<i>-36.7%</i>	<i>-38.6%</i>	<i>-37.6%</i>	<i>-36.9%</i>	<i>-36.2%</i>
YoY Growth	31.5%	23.5%	29.3%	32.9%	17.0%	11.1%	9.2%	7.6%
GAAP Operating Income	12,420	14,540	22,899	24,879	16,247	27,630	38,858	51,502
<i>Operating Income Margin %</i>	<i>5.3%</i>	<i>5.2%</i>	<i>5.9%</i>	<i>5.3%</i>	<i>3.1%</i>	<i>4.6%</i>	<i>5.8%</i>	<i>7.1%</i>
YoY Growth	202.4%	17.1%	57.5%	8.6%	-34.7%	70.1%	40.6%	32.5%

- Over capacity should be diluted during the next 3yrs.
- During the pandemic rush and disorderly growth, Amazon grew fulfillment capacity 50%.
- Revenue grew faster and margins jumped to all time highs.
- The post pandemic environment has seen lower demand for products/retail and margins are suffering.
- As sales expand again, they should offset the higher fixed cost , while orderly growth incurs far more orderly costs.
- Under my estimates, EBIT margin could reach 7.1% by YE25.

Amazon: Net margins expand over the next 3yrs

Amazon US\$m	2018	2019	2020	2021	2022E	2023E	2024E	2025E
GAAP Operating Income	12,420	14,540	22,899	24,879	16,247	27,630	38,858	51,502
Operating Income Margin %	5.3%	5.2%	5.9%	5.3%	3.1%	4.6%	5.8%	7.1%
YoY Growth	202.4%	17.1%	57.5%	8.6%	-34.7%	70.1%	40.6%	32.5%
Interest Income	441	833	555	448	595	1,109	1,581	2,138
% Avg Net Cash Balance	1.7%	2.5%	1.4%	1.1%	1.1%	1.2%	1.2%	1.2%
Interest Expense	(1,418)	(1,600)	(1,647)	(1,809)	(1,872)	(1,794)	(1,643)	(1,453)
Other Income/Expense, Net	(182)	202	2,371	14,633	(8,570)	-	-	-
Pre-Tax Income	11,261	13,975	24,178	38,151	6,399	26,945	38,796	52,188
Pre-Tax Income Margin %	4.8%	5.0%	6.3%	8.1%	1.2%	4.5%	5.8%	7.2%
YoY Growth	195.8%	24.1%	73.0%	57.8%	-83.2%	321.1%	44.0%	34.5%
Income Tax Provision	(1,196)	(2,373)	(2,863)	(4,791)	(1,028)	(6,043)	(8,697)	(11,696)
Effective tax rate	-10.6%	-17.0%	-11.8%	-12.6%	-16.1%	-22.4%	-22.4%	-22.4%
YoY Growth	55.3%	98.4%	20.6%	67.3%	-78.6%	488.1%	43.9%	34.5%
Equity Method Investment Activity, r	8	(14)	16	4	(4)	(4)	(4)	(4)
GAAP Net Income	10,073	11,588	21,331	33,364	5,368	20,898	30,095	40,488
Net Income Margin %	4.3%	4.1%	5.5%	7.1%	1.0%	3.5%	4.5%	5.6%
YoY Growth	232.1%	15.0%	84.1%	56.4%	-83.9%	289.3%	44.0%	34.5%