Amazon.com

Consumer Discretionary
NASDAQ: AMZN
Market Outperform | Buy

Calgary Portfolio Management Trust

September 30, 2024

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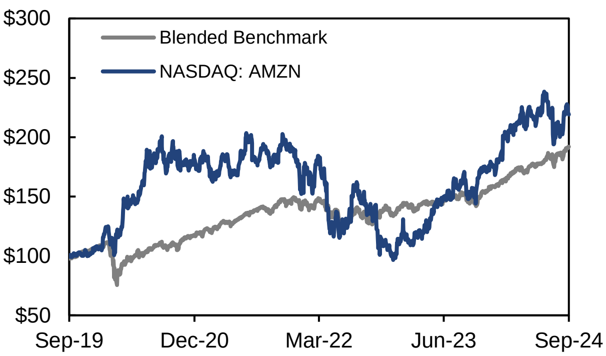
Return on Investment	
Current Share Price	$186.33
Target Price	$219.42
Dividend Yield	N/A
Implied Return	18%
Conviction Rating	1

Market Profile	
52-Week Range	$119.57 - $200.00
Market Capitalization (US$B)	$1,956
Net Debt (US$B)	$61
Enterprise Value (US$B)	$2,017
Beta (5-Year Monthly)	1.10

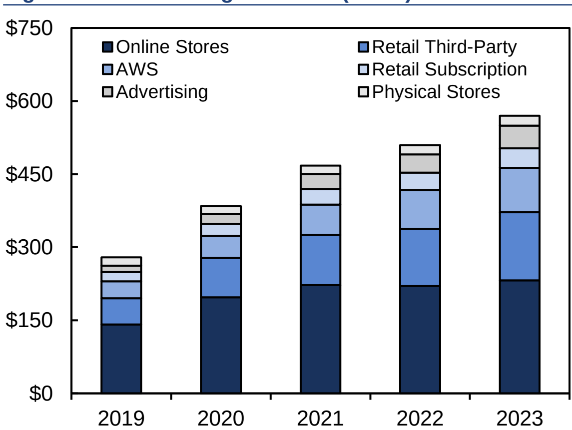
Metrics	2023	2024E	2025E
Revenue (US$B)	$575	$637	$704
EBITDA (US$B)	$86	$116	$137
EPS	$2.90	$4.73	$5.93
EV/EBITDA	23.6x	17.4x	14.7x

Historical Trading Performance (Indexed to $100)



Source: Bloomberg

Figure 1: Revenue Segmentation (US$B)



Source: Bloomberg, Company Fillings

Business Description

Amazon.com (NASDAQ: AMZN) is a multinational e-commerce information technology firm that provides digital retail shopping services. The products sold on the Company's e-commerce platform are supplied both by AMZN and its third-party affiliates. The Company's retail e-commerce service is complemented by a range of offerings provided through AMZN's subscription-based Amazon Prime ecosystem. These services include same-to-two-day shipping on millions of items, free streaming access to a variety of digital content, and affordable access to prescription medications. The Company is organized into three main operating segments: (1) North America, (2) International, and (3) Amazon Web Services (AWS).

The North America and International segments include revenues from the retail sales of products and subscriptions within AMZN's respective geographical operations. The Company's AWS segment provides an on-demand cloud computing platform for individuals and organizations within private and public sectors. AWS offers computational power, storage, and database services on a pay-as-you-go basis, making the services significantly more cost-efficient and scalable than on-premises substitutes.

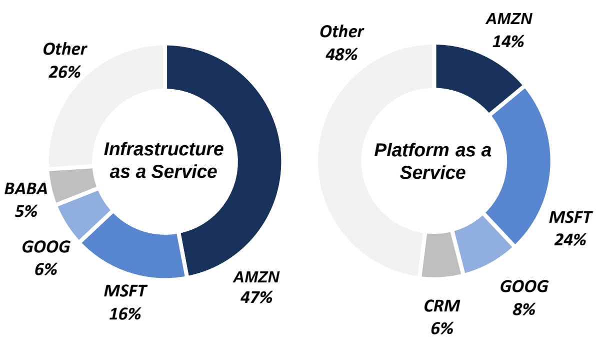
Industry Overview

Over the past two decades, e-commerce has rapidly gained traction and disrupted the retail space due to its superior convenience and lower prices compared to brick-and-mortar retail channels. Currently, AMZN dominates the U.S. e-commerce market, with 37.6% of revenue market share, followed by Walmart (NYSE: WMT) at 6.4%. However, the industry is becoming increasingly competitive, with newer entrants to the U.S. market, such as Alibaba (NYSE: BABA) and Temu (NASDAQ: PDD), offering lower prices with the tradeoff of longer delivery times. Overall, e-commerce penetration is expected to continue to expand, driving U.S. e-commerce sales to grow at a five-year CAGR of ~10.5%

The cloud computing industry allows customers to utilize on-demand computational power and data storage without substantial upfront investment in hardware and infrastructure. The industry operates on a pay-as-you-go basis, facilitating a highly flexible and cost-efficient structure for customers. Additionally, cloud computing platforms often offer a variety of tools for data analytics and the development of artificial intelligence (AI) models, allowing customers to extract greater value from their data and drive efficiency within their organizations. In 2006, AMZN gained its first-mover advantage in the cloud infrastructure space with AWS. In the following years, Microsoft (NASDAQ: MSFT) and Google (NASDAQ: GOOGL) entered the market with Microsoft Azure and Google Cloud Platform (GCP). These three firms now hold a dominant stake in the market, with AMZN maintaining the largest market share at ~31%.

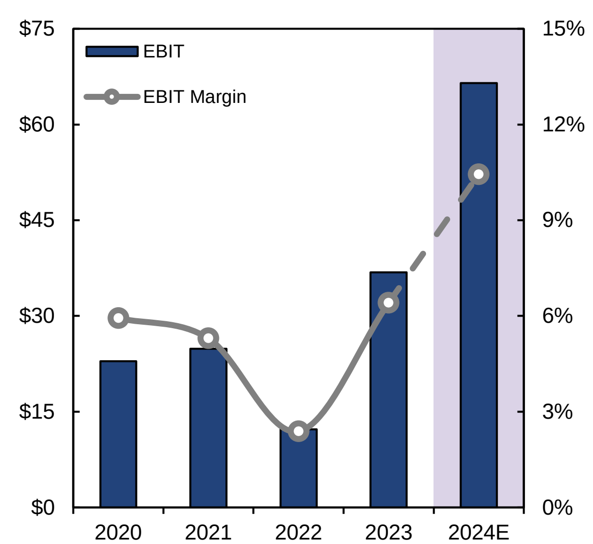
The transition to cloud computing is still developing, as ~85% of workloads remain on-premises. This generates strong growth opportunities, as organizations continue to migrate to the cloud. Despite certain headwinds slowing the rate of cloud adoption, such as a lack of internal expertise and complex migration processes, increased use cases for large language models have proven to be a significant catalyst for cloud migration. This can be attributed (cont.)

Figure 2: 2023 Cloud Computing Market Share



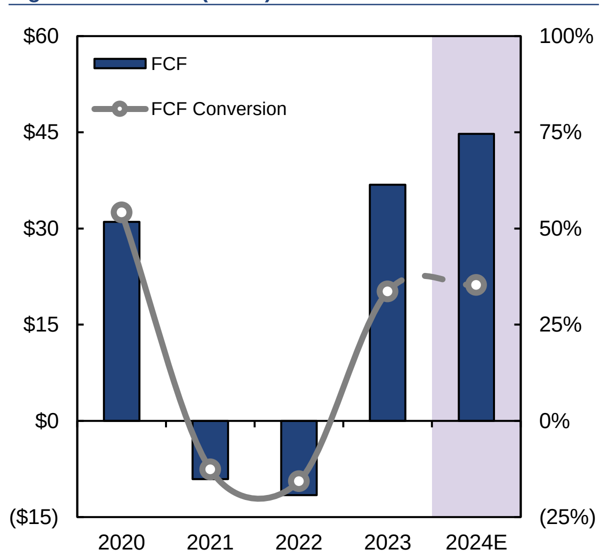
Source: Bloomberg, Company Filings

Figure 3: LHS EBIT (US$B) vs RHS EBIT Margin



Source: Bloomberg, Company Filings, CPMT Estimates

Figure 4: LHS FCF (US$B) vs RHS FCF Conversion



Source: Bloomberg, Company Fillings, CPMT Estimates

to the significant capital and expertise required to develop and maintain scalable, on premises infrastructure for AI applications. This will further contribute to a strong growth runway in cloud computing, as enterprises continue to seek AI efficiency gains.

Mandate Fit

Quality Management: Andy Jassy serves as AMZN's CEO, assuming the role in 2021 after Jeff Bezos transitioned to Executive Chair of the Board. Jassy joined the Company in 1997 after graduating with an MBA from Harvard Business School. Throughout his tenure at AMZN, Jassy has proven to be an excellent innovator and operator, co-founding AWS and guiding it to its dominant market position in the cloud computing space.

AMZN's management team governs with a customer-centric focus and a prioritization of long-term thinking. These core principles are reflected in the Company's operational strategy, which includes continuous reinvestment to improve delivery speeds, decrease prices, and expand the range of services offered through Amazon Prime. Specifically, over the last five years, AMZN introduced free one-day and same-day shipping for Prime members and launched Amazon Pharmacy and Amazon Health.

Furthermore, the Company's long-term focus is reinforced by its compensation structure, with 96% of NEO compensation at-risk. This at-risk compensation is solely derived from stock awards with long, backend-weighted vesting periods rather than short-term incentives.

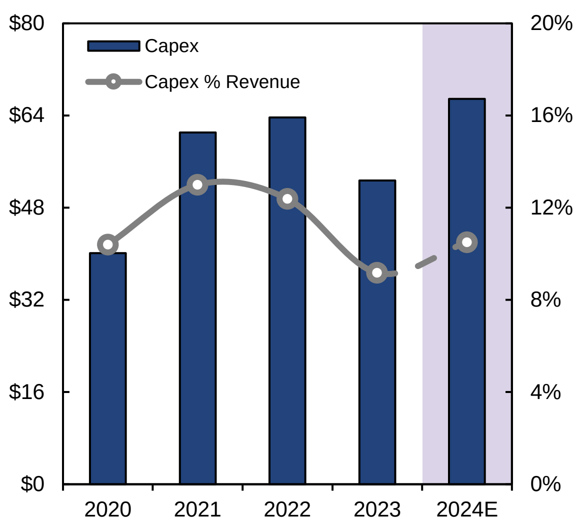
Competitive Advantage: AMZN's e-commerce business benefits from its expansive scale and robust logistics network. This allows the Company to provide customers with unmatched variety, low prices, and convenience. Moreover, the growing prevalence of Amazon Basics has assisted AMZN with capturing share in the non-discretionary market from brick-and-mortar retailers. This end market is characterized by more consistent, frequent purchases, highlighting the Company's priority of incentivizing habitual shopping behaviour. The Prime ecosystem further drives customer retention, with Prime members spending two times more on average than nonmembers.

AMZN's AWS segment benefits from high switching costs due to its extensive integration with its clients' key operations. Migrating between cloud providers requires operational downtime, staff retraining, and becomes more cumbersome for clients with high amounts of integration with their provider. Moreover, AWS' open-source model provides clients with a high degree of customizability and the broadest depth of cloud-based features available on the market, further driving customer dependence on the platform.

Strong Balance Sheet: AMZN prioritizes low, strategic leverage and strong capital discipline. Throughout FY2021 and FY2022, the Company invested significantly in its data centres and doubled the size of its logistics network, causing Net Debt/EBITDA to peak at 1.5x in Q1 2023. During the remainder of the year, management committed to deleveraging. Net Debt/EBITDA currently sits at 0.5x, in line with AMZN's 10-year average. Furthermore, the Company has strong short-term liquidity, with a quick ratio of ~0.9x, a current ratio of 1.1x, and a large cash position of US$89.1B. Management's dedication to maintaining low leverage, along with the Company's robust cash flows, results in an AA credit rating from S&P.

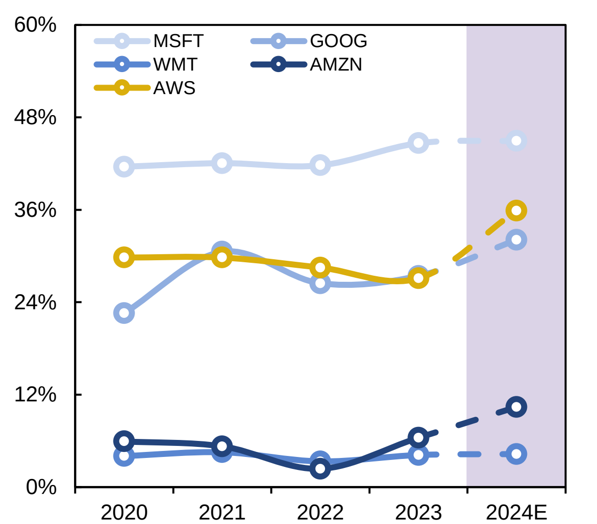
Growing Free Cash Flow: Outside of the two consecutive years of negative FCF in FY2021 and FY2022 due to substantial capital investments, AMZN has seen significant FCF growth, with a 10-year CAGR of 33.6%. More recently, the Company's FCF growth has been driven by margin expansion and capex moderation.

Figure 5: LHS Capex (US$B) vs RHS Capex % of Revenue



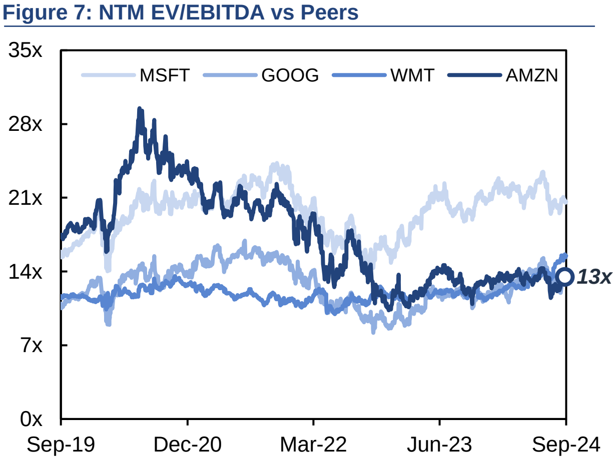
Source: Bloomberg, Company Filings, CPMT Estimates

Figure 6: Operating Margin vs Peers



Source: Bloomberg, Company Filings, CPMT Estimates

Figure 7: NTM EV/EBITDA vs Peers



Source: Bloomberg

AMZN is experiencing rapid growth in its high-margin services, notably AWS, which reported an operating margin of 36.5% in H1 2024 versus 10.3% on an aggregate basis. This is further supported by the improving profitability of the Company's e-commerce business, driven by the ongoing regionalization of its fulfillment network. As a result, consolidated operating margins have increased from 5.3% in 2021 to 9.0% in the LTM. Additionally, capex as a percentage of revenue has decreased from its peak of 13.0% in FY2021 to 9.9% in the LTM. Although capex is expected to remain elevated over the next few years due to significant investments in data centres and generative AI, the CPMT expects this to be offset by strong topline growth and continued margin expansion.

Risks

Consumer Uncertainty: Shifts in consumer demand and spending patterns pose a risk to AMZN's retail business. Over the past year, weakening consumer sentiment has led to a sales mix shift towards non-discretionary items with lower average selling prices. This has proven to be a slight headwind for the Company due to the lower margins and less favorable economics from shipping low-cost products. However, these headwinds were partially offset by increased volumes due to more habitual purchases.

AWS' Macroeconomic Sensitivity: AWS has enjoyed double-digit growth over the last five years. However, recent macroeconomic headwinds, including inflation and rising interest rates, led to reduced enterprise spending on cloud services. From FY2022-FY2023, companies prioritized cost optimizations over new workload deployments in the midst of an uncertain economic landscape. This led AWS' revenue growth to slow from 28.8% to 13.3% over the same period. Although AWS is sensitive to the prevailing macroeconomic environment, the CPMT believes that the secular growth opportunities in the industry should mitigate this risk.

Supply Chain Disruptions: AMZN's supply chain is vulnerable to disruptions from various factors, including transportation bottlenecks, geopolitical events, and natural disasters. These events could lead to delays in product availability and increased shipping costs, which could have a material impact on the Company.

Investment Thesis and Valuation

AMZN was valued at $219 using a 10-year DCF and a WACC of 8.3%. The terminal growth rate was derived using a 70/30 blend of (1) the Gordon Growth method, assuming a terminal growth rate of 2.5%, and (2) and EV/EBITDA exit multiple of 13.0x. This provides an implied return of ~17.8%

The CPMT believes that AMZN is poised for margin expansion and is well-positioned to capture secular growth opportunities in the e-commerce and cloud industries due to its leading logistics network and data centre investments. AMZN's efforts to decrease its cost to serve, such as the regionalization of its fulfillment network, will help to lift e-commerce margins and expand its product offerings. Additionally, the Company's fastest growing operating segments, AWS and advertising, have the highest margins, indicating a positive revenue mix shift. AMZN's e-commerce business is set to benefit from the growing share of online retail volumes, with e-commerce expected to comprise 30% of total retail sales in 2028 versus 23% in 2023. The Company's AWS business is also positioned for significant growth, with the rising prevalence of generative AI accelerating the shift towards cloud computing. Furthermore, the segment has substantial growth runway, with the cloud industry only seeing ~10% of IT expenditures.