AMAZON

Amazon: the $1 trillion question

Does Amazon's cloud computing arm make the tech giant recession and Trump-proof?

by JOHN SCHAFFER
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In a peer group of US tech firms which have in recent years routinely traded at valuations well above 20x forecast earnings, it may seem counterintuitive to ask if a stock is materially undervalued.

On the face of it this may seem doubly true of online retail behemoth Amazon. In addition to a headline 2020 PE multiple of 56x, the company's sheer size has made it a prime target of the recent tech backlash, as politicians question whether online giants have become dangerously monopolistic.

Even at that multiple, a share price of $1,739 and a market cap of $860 billion (£630 billion) the stock is well off recent highs above $2,000, and a total value above $1 trillion. But many market watchers believe it remains fundamentally misunderstood, with the most bullish analysts offering targets from $2,500 to $3,200.

At issue is the company's cloud computing arm Amazon Web Services (AWS). While the retail business may be comparatively easy to understand, many fund managers say AWS's potential is both much more opaque and much more exciting.

What price Amazon?

Morningstar analyst RJ Hottovy believes Amazon could be worth as much as $1.2 trillion, attributing $550 billion of that to AWS versus the retail division's $446 billion (see chart). He views the non-public face of the business as 'misunderstood and underappreciated'.

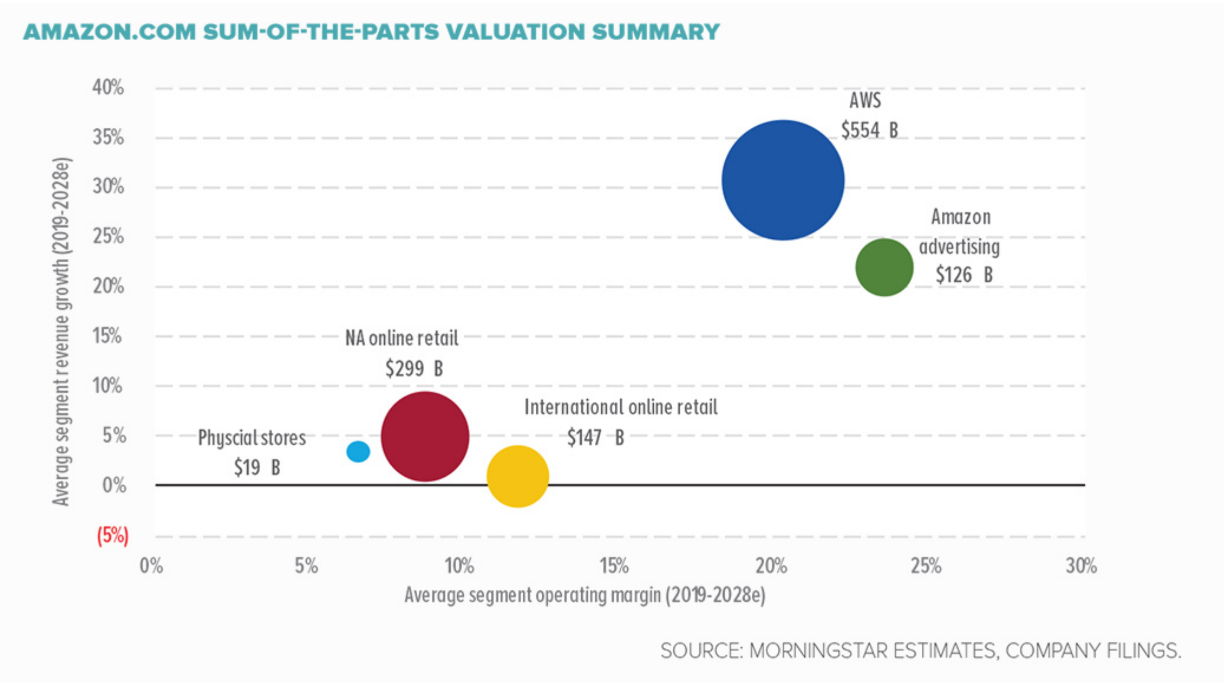
'We see AWS as Amazon's most important cash flow contributor over the next decade, with advertising beginning to take the mantle roughly a decade out. Both segments offer more significant margin expansion opportunities than the market is giving them credit for.'

The firm racked up revenue of $233 billion in 2018, and Morningstar predicts that this will grow to $490 billion by 2023.

Jeremy Gleeson (*pictured above*), manager of Axa Investment Management's Framlington Global Technology fund, shares the optimism and says that there could be 15-30% upside in Amazon's share price over the next year. He said: 'There's been a massive growth of AWS. The cloud business grew by 37% last year, but it is also highly profitable, which is unusual for a high growth business.'

However Gleeson, who has over 2% of his fund allocated to Amazon, also has 'some hesitation' due to the US political landscape. Amazon founder and largest shareholder Jeff Bezos, who holds 15% of the stock, is a regular target of Donald Trump's Twitter ire. Bezos owns and has recently heavily invested in the Washington Post, one of the US media organisations most critical of the Trump administration

'There's potential for volatility in Amazon's share price in the run up to the US election, as the debate over breaking up large tech firms will be discussed by all presidential candidates,' he added.



Under heavy scrutiny

Trump has previously threatened a wider investigation into Amazon's dominance in online retail, with the company accounting for over 40% of e-commerce spending in the US.

Antitrust regulations in the US that scrutinise the presence of monopolies have put large tech companies in the spotlight, and Amazon's dominance has certainly attracted attention.

Christopher Rossbach, manager of J. Stern & Co's World Stars Global Equity fund, thinks that a break up of Amazon is unlikely, however: 'I don't see what a break up would achieve.' He adds that Amazon's underlying businesses are 'well ringfenced', so it is unlikely there would be much impact on valuation.

Gleeson adds that the confusion over how to price the group meant enforced spin-offs could actually be a catalyst for realising shareholder value: ‘If there was a break-up of the business, there would be short-term volatility. However, the market would eventually be able to apply more efficient valuations for the individual businesses.’

Recession-proof?

How would Amazon fair in a recession?

With murmurings of a major shock on the horizon, what would another global recession do to Amazon’s valuation? Rossbach says that the resilience of AWS means that there would unlikely be significant damage, even if its current hectic growth rate slowed.

‘If there was a major slowdown, overall consumer spending would go down. But the AWS business isn’t cyclical, as users interact with it all the time. It’s primarily used by multi-million dollar businesses
and governments, rather than individuals and SMEs,' he said.

‘With cloud computing, we’re so early in terms of the importance of data and the amount of data that is being generated. I would really expect Amazon’s cloud business to be almost unaffected by a shock.’

Hottovy adds that even the e-commerce business is unlikely to be deeply impacted, due to the firm’s competitive pricing. ‘E-commerce companies react more like defensive retailers during periods of economic softness, with consumers still relying heavily on marketplaces like Amazon because of competitive pricing and the convenience of expedited shipping.

‘AWS and Amazon Advertising should help to insulate the company during the next cyclical downturn and reinforce the company's vastly different business mix compared with the 2008-09 recession.’

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