



## Amazon: king of the jungle

Markets are unpredictable and volatile. Over the past few weeks, the high-flying technology sector has declined substantially as inflationary concerns rise to the fore. The tech sector is a jungle – it's a ruthless, competitive yet innovative sector where there is always a new kid on the block snapping at your heels. But like the jungle, some survive and flourish to dominate all those around it. Amazon is a case in point.



**Michael  
Porter**

I am sure that most clients are familiar with Amazon by name and have probably ordered something from the ubiquitous website. It was really the first company to conquer online retail – initially selling music and books. But that narrow product range soon expanded, to the point where Amazon now boasts a product range of more than 45 million items, shipped to customers around the world. The company was listed in 1997 at \$1.50

per share. By late 2000, the price had risen to over \$80 – a phenomenal return. But the bursting of the dot-com bubble saw the price plummet back to \$10. That was then. Today, Amazon's share price is about \$3200 per share – an annual compound return of 38% since listing.

Whilst Amazon started as a purely online store, the company has expanded rapidly and aggressively – by widening its product range, investing in its distribution and fulfilment to ensure the best possible customer experience, and becoming a platform through which other retailers can sell their own products. In hindsight, these have proven to be very shrewd decisions. By offering the widest range of goods and delivering them quickly, Amazon ensured that it cemented its position as the starting point for any online purchase. Exponentially rising client numbers and transactions then helped the company to achieve economies of scale, which in turn allowed further investment into the factors above. The result – a self-fulfilling virtuous cycle of strong growth that fueled further innovation, which in turn fueled strong growth.

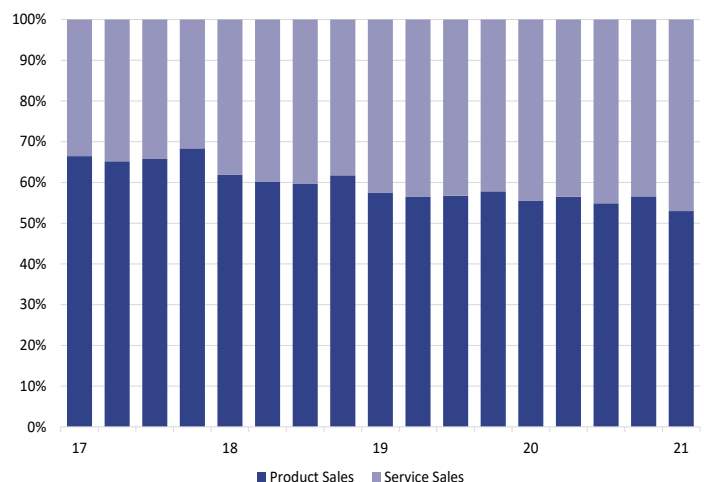
Most entrepreneurs will agree that the holy grail for any business is to earn what is termed “annuity income” – ie, revenues that recur monthly regardless of whether the customer buys anything or not. Typically, retailers do not enjoy annuity-type revenues – their revenue is dependent on a customer buying something every day. Some days can be busy, others quiet.

### SPEED READ

- In 2022, Amazon will celebrate its 25th anniversary as a listed company.
- Whilst it hasn't always been plain-sailing, Amazon's growth and profitability have accelerated exponentially over time, and especially over the past 4 quarters.
- One of the reasons for its success is its ability to continuously expand its range of services – the company is so much more than just an online store.
- Amazon's revenue last year was larger than the size of SA's entire GDP.

Amazon recognized the benefit of annuity income a long time ago and launched Amazon Prime that would not only help it to grow revenues, but also to boost margins and further entrench

### REVENUE CONTRIBUTION BY PRODUCT

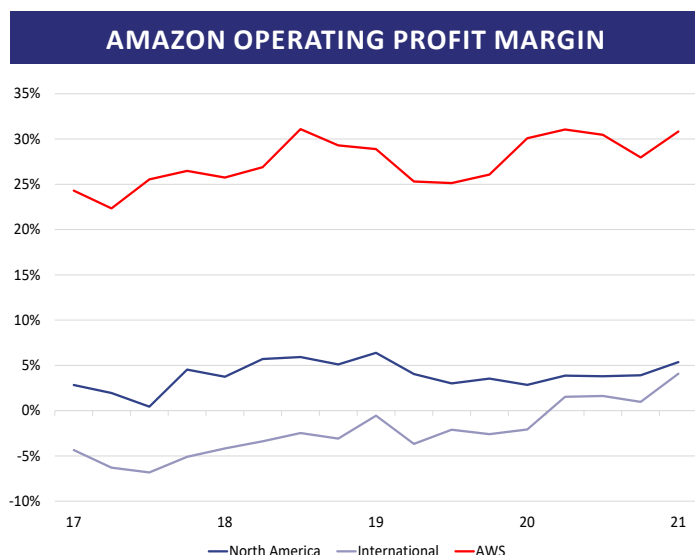


*Over time, Amazon is successfully growing its share of annuity revenues (services), moving away from its reliance on pure retail sales.*

customer loyalty. For a small monthly fee, subscribers got faster and cheaper delivery and access to special offers. But Amazon Prime has morphed into a much larger “beast”. Prime now boasts over 200 million paid subscribers every month, who enjoy numerous benefits, including music and video streaming and more recently even things such as pharmaceutical prescription services. Netflix is normally the first company one thinks of when mentioning video streaming. It has 208 million subscribers. Impressive? 175 million Prime subscribers streamed videos from Amazon last year, and hours watched soared 70% - surely a consequence of forced lockdowns. But like Netflix, Amazon has become a content provider in its own right. Its Studios operations received 12 Academy Award nominations last year.

Fifteen years ago Amazon launched its other child – Amazon Web Services (AWS) – in response to the growing demand for cloud-based IT services. Over that short period, AWS has grown into a division earning close to \$50 billion and \$15 billion of revenue and operating profit respectively. Its services are used by companies such as Airbnb, McDonalds and Volkswagen but the list is expanding quickly. Currently, AWS is the backbone behind Disney’s plans to expand its streaming service globally.

Retail can be a low margin business – generally high margins are eroded by competition over time. The same applies to Amazon – where margins in North America hover around 5%. It is also noteworthy that only in the last 12 months have Amazon’s international retail operations (outside of North America) turned profitable. On the other hand, AWS is a significantly higher margin division – earning margins of about 30% - which highlights its importance to the Group. Whilst



*Retail is a traditionally low margin business, and incredibly, their international operations have only recently turned profitable. But their diversification into cloud infrastructure was shrewd and delivers substantially higher margins.*

AWS only accounts for 13% of total revenues, it accounts for almost 50% of profits.

I could write pages about the various initiatives that Amazon has underway to secure its place for the future – from Amazon Scout – a fully autonomous delivery system that delivers parcels right to your door, to their “Just Walk Out” technology which removes the need for cashiers in shops. Amazon now has 15 fresh grocery stores worldwide (with 3 just opened in London) where this technology is on trial. Furthermore, Amazon is launching more and more of its own “private label” products – a huge opportunity to capture additional margin as consumers gravitate towards brands that they can trust.

Rising revenues and profits are all well and good, but most clients will know from the press that the technology sector was the star performer last year. Amazon was no exception. Over 2020, its share price rose 76%. Is all this good news already reflected in the price? The chart below shows the forward p/e ratio over the past 11 years. Despite the seemingly meteoric rise in its share price, the chart implies that profits have risen just as quickly. The forward rating is towards the bottom end of the range that has prevailed for the past decade, implying that Amazon is no more expensive today than it was in 2011. The technology sector has come under pressure in recent weeks, but there is a large discrepancy in performance



*Despite its strong share price rally, profits have grown just as fast, implying that Amazon’s valuation is at the bottom end of its historic range.*

between those companies that are profitable versus those that are not. The latter has been far more vulnerable to significant share price weakness. Fortunately, Amazon falls squarely into the former camp. Pent up consumer demand, coupled with an exponential rate of innovation, should ensure that Amazon’s profitability continues to go from strength to strength.



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Please save the date below. Please note that due to Covid protocols, numbers are strictly limited to 100 per session, and only drinks (no food) will be served. Booking is therefore essential.



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**Topic:**

**To be announced**

### **Natal Midlands**

|               |   |
|---------------|---|
| Date:         | 24th June 2021                                    |
| Venue:        | Fernhill Hotel<br>Midmar / Tweedie Road<br>Howick |
| Morning Time: | 10am for 10.30am                                  |
| Evening Time: | 5.30pm for 6pm                                    |

### **Johannesburg**

|        |   |
|--------|---|
| Date:  | 08 July 2021  |
| Venue: | Rosebank Union Church, Cnr<br>William Nichol and St Andrews<br>Road, Hurlingham |
| Time:  | 7am for 7.30am  |

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### **HARVARD HOUSE GROUP**



3 Harvard Street, Howick, 3290, South Africa



P.O. Box 235, Howick, 3290, South Africa



+27 (0) 33 330 2164



+27 (0) 33 330 2617



[admin@hhgroup.co.za](mailto:admin@hhgroup.co.za)



[www.hhgroup.co.za](http://www.hhgroup.co.za)

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