Amazon.cn Valuation Project

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Our team project is focus on the Amazon financial statement and analysis the valuation the Amazon. We use several websites to get the information about the Amazon. We also use preliminary cash flow valuation methods and market value added and economic value added. Then we will analysis the future tendency of the Amazon. At last, we summary the report and make an oral presentation.

Introduction:

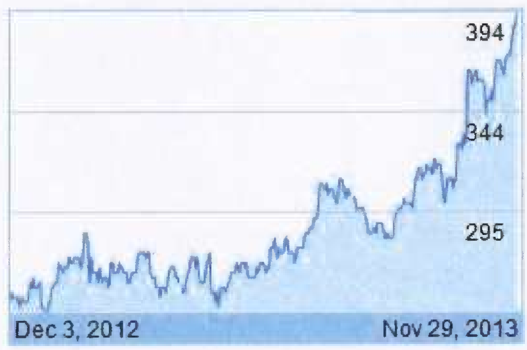
The company was founded in 1994, spurred by what Bezos called his "regret minimization framework", which described his efforts to fend off any regrets for not participating sooner in the Internet business boom during that time. In 1994, Bezos left his employment as vice-president of D. E. Shaw & Co, a Wall Street firm, and moved to Seattle. He began to work on a business plan for what would eventually become Amazon.com.

After reading a report about the future of the Internet which projected annual Web commerce growth at 2,300%, Bezos created a list of 20 products which could be marketed online. He narrowed the list to what he felt were the five most promising products which included: compact discs, computer hardware, computer software, videos, and books. Bezos finally decided that his new business would sell books online, due to the large world-wide demand for literature, the low price points for books, along with the huge number of titles available in print. Amazon was originally founded in Bezos' garage in Bellevue, Washington.

The company began as an online bookstore, an idea spurred off with discussion with John Ingram of Ingram Books along with Keyur Patel who still holds a stake in Amazon. In the first two months of business, Amazon sold to all 50 states and over 45 countries. Within two months, Amazon's sales were up to $20,000/week. While the largest brick and mortar bookstores and mail order catalogs might offer 200,000 titles, an online bookstore could "carry" several times more, since they had an almost unlimited virtual (not actual) warehouse: those of the actual product makers/suppliers.

Background:

Historical chart



Amazon calculates "Free Cash Flow" in its financial statements as Cash from Operations less Capital Expenditures, and hence is a bit different than the above definition. But since Amazon has always held very minimal amounts of debt, I use Amazon's definition of FCF for consistency and do not make an adjustment for interest payments.

Amazon has had positive FCF in every year since 2002 and FCF peaked at $2.92 billion in 2009 - since then, FCF has steadily decreased to $395M in 2012 and $387M over the past twelve months.

Income Statement Analysis of Amazon

Income Statement Annual Data from Amazon

Income Statement Get Income Statement for: GO

View: **Annual Data** | Quarterly Data All numbers in thousands

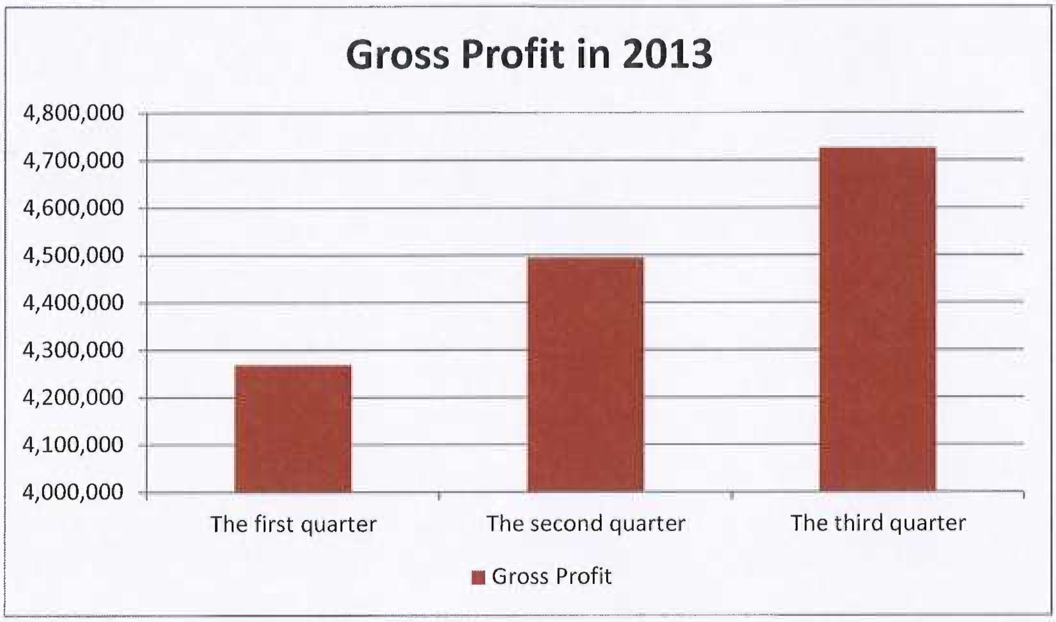
Period Ending	Dec 31, 2012	Dec 31, 2011	Dec 31, 2010
Total Revenue	61,093,000	48,077,000	34,204,000
Cost of Revenue	45,971,000	37,288,000	26,561,000
Gross Profit	15,122,000	10,789,000	7,643,000
Operating Expenses			
Research Development	-	-	-
Selling General and Administrative	14,446,000	9,927,000	6,237,000
Non Recurring	-	-	-
Others	-	-	-
Total Operating Expenses	-	-	-
Operating Income or Loss	676,000	862,000	1,406,000
Income from Continuing Operations			
Total Other Income/Expenses Net	(40,000)	137,000	130,000
Earnings Before Interest And Taxes	636,000	999,000	1,536,000
Interest Expense	92,000	65,000	39,000
Income Before Tax	544,000	934,000	1,497,000
Income Tax Expense	428,000	291,000	352,000
Minority Interest	-	-	-
Net Income From Continuing Ops	(39,000)	631,000	1,152,000
Non-recurring Events			
Discontinued Operations	-	-	-
Extraordinary Items	-	-	-
Effect Of Accounting Changes	-	-	-
Other Items	-	-	-
Net Income	(39,000)	631,000	1,152,000
Preferred Stock And Other Adjustments	-	-	-
Net Income Applicable To Common Shares	(39,000)	631,000	1,152,000

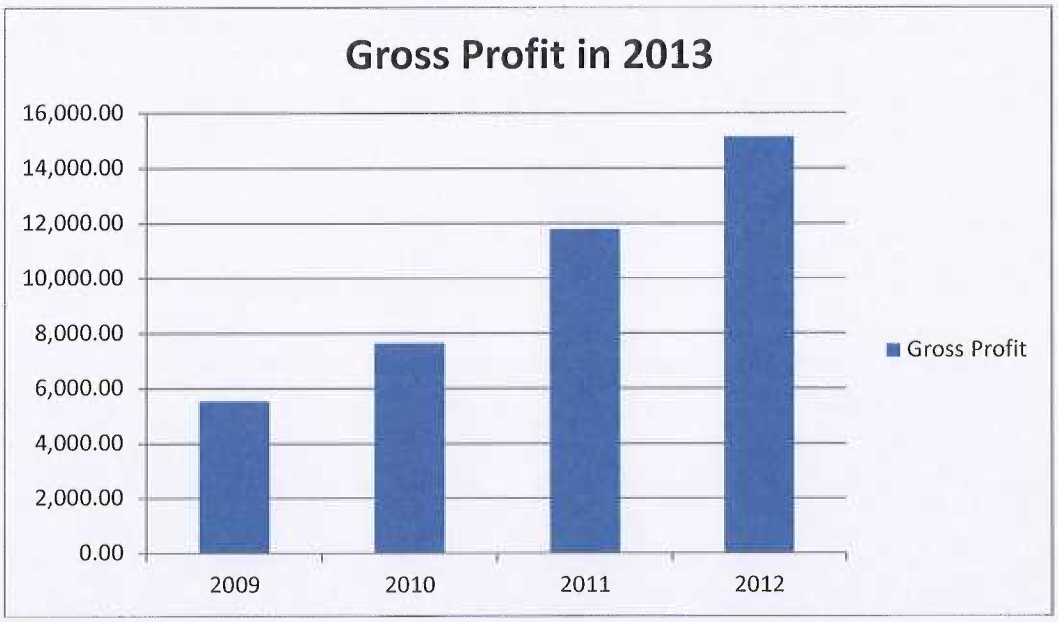
Income Statement Quarterly Data from Amazon

Income Statement Get Income Statement for: GO

View: Annual Data | **Quarterly Data** All numbers in thousands

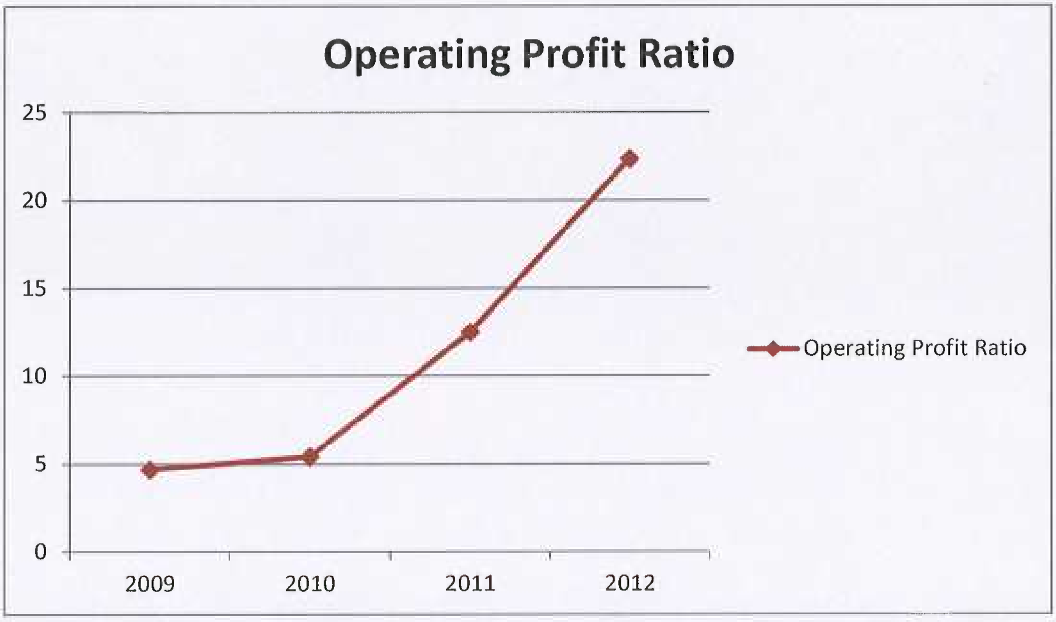
Period Ending	Sep 30, 2013	Jun 30, 2013	Mar 31, 2013	Dec 31, 2012
Total Revenue	17,091,000	15,704,000	16,070,000	21,268,000
Cost of Revenue	12,365,000	11,209,000	11,801,000	16,137,000
Gross Profit	4,726,000	4,495,000	4,269,000	5,131,000
Operating Expenses				
Research Development	-	-	-	-
Selling General and Administrative	4,751,000	4,416,000	4,088,000	4,726,000
Non Recurring	-	-	-	-
Others	-	-	-	-
Total Operating Expenses	-	-	-	-
Operating Income or Loss	(25,000)	79,000	181,000	405,000
Income from Continuing Operations				
Total Other Income/Expenses Net	17,000	(29,000)	(67,000)	(41,000)
Earnings Before Interest And Taxes	(8,000)	50,000	114,000	364,000
Interest Expense	36,000	33,000	33,000	27,000
Income Before Tax	(44,000)	17,000	81,000	337,000
Income Tax Expense	(12,000)	12,000	(18,000)	194,000
Minority Interest	-	-	-	-
Net Income From Continuing Ops	(41,000)	(7,000)	82,000	98,000
Non-recurring Events				
Discontinued Operations	-	-	-	-
Extraordinary Items	-	-	-	-
Effect Of Accounting Changes	-	-	-	-
Other Items	-	-	-	-
Net Income	(41,000)	(7,000)	82,000	98,000
Preferred Stock And Other Adjustments	-	-	-	-
Net Income Applicable To Common Shares	(41,000)	(7,000)	82,000	98,000

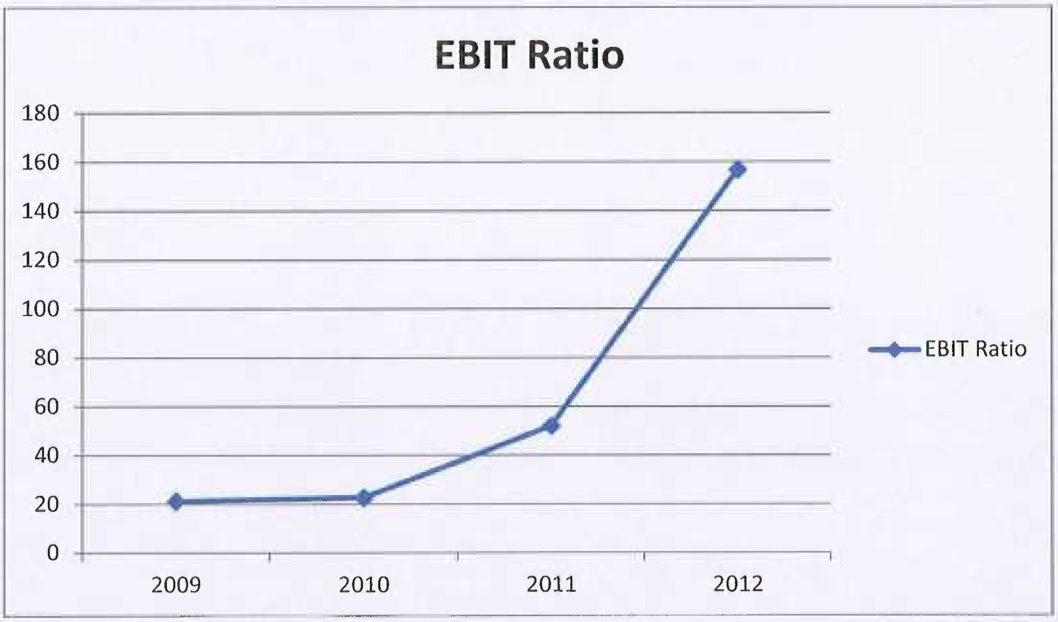




In the income statement analysis, the gross profit is an important index that investors will pay attention to. As we can see from the chart, the gross profit of Amazon increases by quarters in 2013.

For the gross profit of Amazon, they not only increase by the quarters, but also the years. It seems that it will have larger trend in the growth of gross profit in the furtheryears.





The growth of sales is mostly paid attention to by investors. The ratio of operating performance often connects the many parts in the income statement to the sales income as well. The most important indexes investors will find are always the operating profit ration and EBIT ratio.

From the chart I made from the collected data, we find the operating profit ratio of Amazon increases by years. The operating profit ratio can reflect the business operating sales in some ways. The increase here indicates the basic profitability of Amazon. The high operating profit ratio explains that Amazon can control their costs well and has high value-added products. At the same time, it indicates that Amazon has huge market potential in the competitive market.

Besides the operating profit ratio of Amazon we analyze, the EBIT ratio is also another very important index that can show the sales performance. We find the EBIT ratio of Amazon increases by the years as well. In the financial analysis, the lower EBIT ratio means that the business doesn't create enough operating income or control the operating expenses well. So from this chart, we find Amazon has higher EBIT ratio by years. It obviously explains that Amazon has had created enough operating income or controlled the cost expenses well. All of above indicate that Amazon has a huge market potential now even though they are a relatively new company which is still building out its platform.

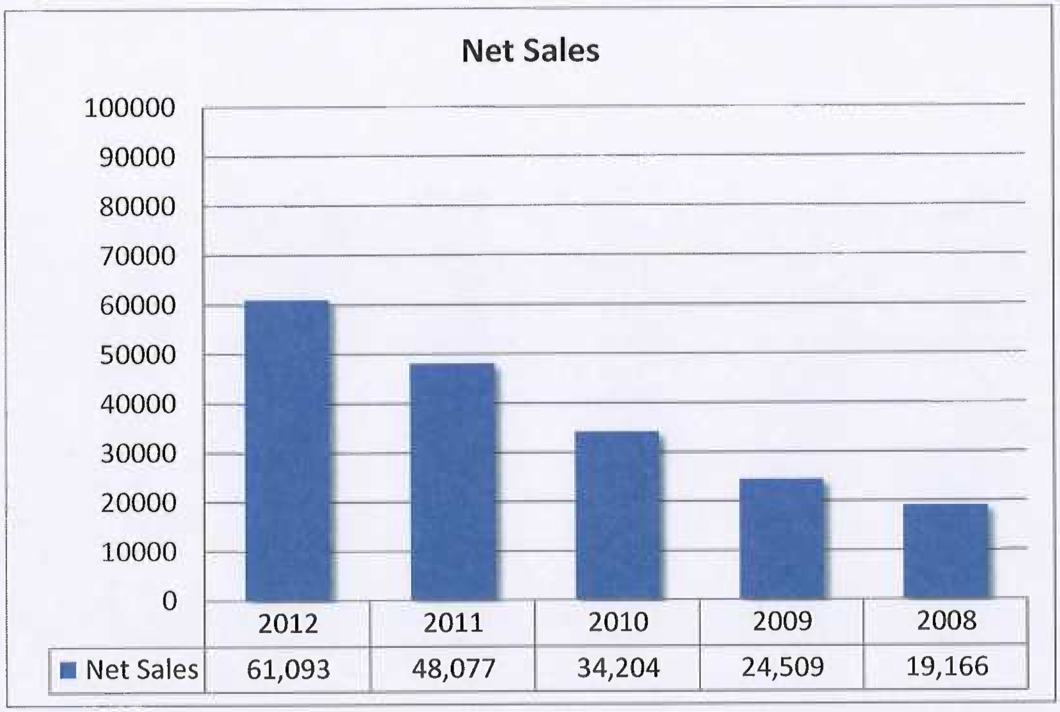
The analysis of net sale

The net sales:

In 2012, the net sales of Amazon are 61,093 million. In compare to 2012, the net sales in 2011 is 48,077 million, 34,204 million in 2010, 24,509 million in 2009 and 19,116 million in 2009.

	Year Ended December 31,				
	2012	2011	2010	2009	2008
	(in millions, except per share data)				
Statements of Operations:					
Net sales	$61,093	$48,077	$34,204	$24,509	$19,166
Income from operations	676	862	1,406	1,129	842
Net income (loss)	(39)	631	1,152	902	645
Basic earnings per share (1)	$ (0.09)	$ 1.39	$ 2.58	$ 2.08	$ 1.52
Diluted earnings per share (1)	$ (0.09)	$ 1.37	$ 2.53	$ 2.04	$ 1.49
Weighted average shares used in computation of earnings per share:					
Basic	453	453	447	433	423
Diluted	453	461	456	442	432
Statements of Cash Flows:					
Net cash provided by operating activities	$ 4,180	$ 3,903	$ 3,495	$ 3,293	$ 1,697
Purchases of property and equipment, including internal-use software and website development	(3,785)	(1,811)	(979)	(373)	(333)
Free cash flow (2)	$ 395	$ 2,092	$ 2,516	$ 2,920	$ 1,364

	December 31,				
	2012	2011	2010	2009	2008
	(in millions)				
Balance Sheets:					
Total assets	$32,555	$25,278	$18,797	$13,813	$ 8,314
Total long-term obligations	5,361	2,625	1,561	1,192	896

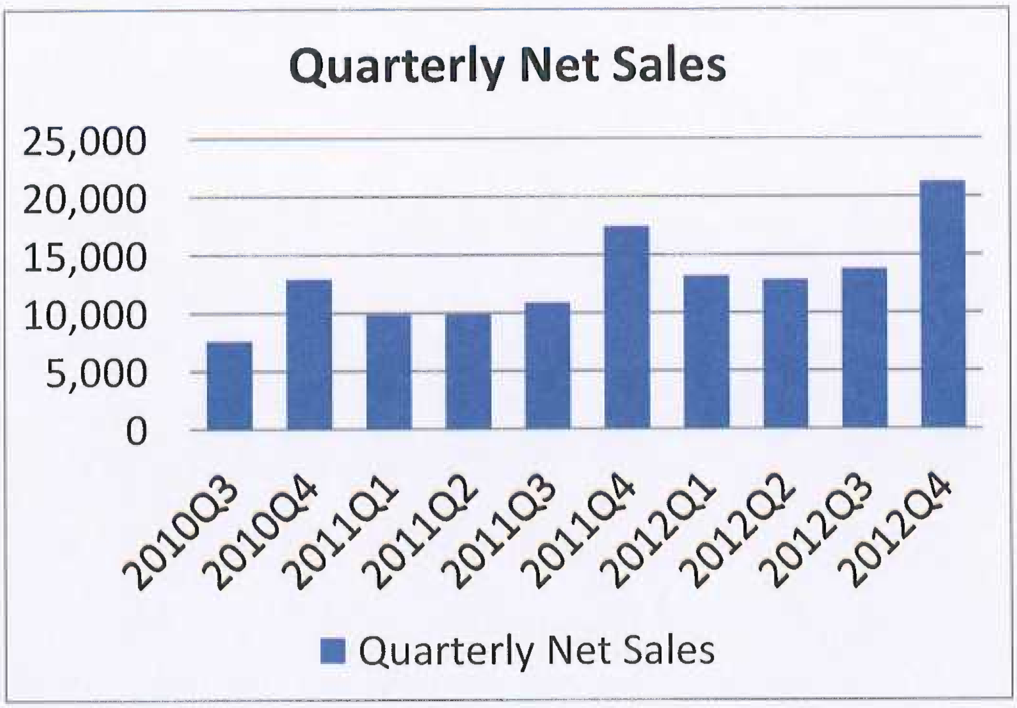


The net sales in 2012 are 61,093 million. The growth of net sales in 2012 is 30%, but in 2011 the growth is 43% and in 2010 is 46%. The growth rate of net sales is slow down.

Quarterly net sales

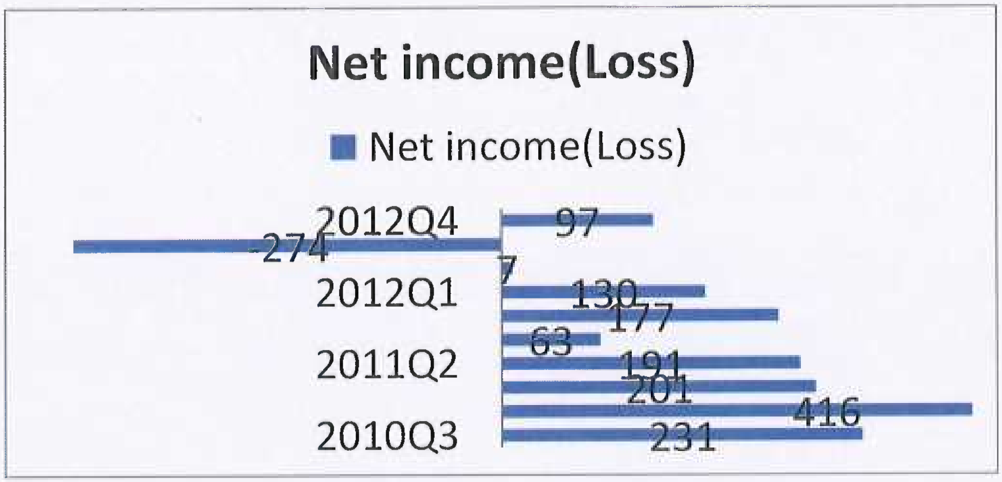
The quarterly net sales in 2012 is 13,185 million in first quarter, 12,834 million in second quarter, 13,806 million in third quarter and 21,268 million in fourth quarter.

	Year Ended December 31, 2011 (1)			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Net sales	$17,431	$10,876	$9,913	$9,857
Income before income taxes	273	130	225	307
Provision for income taxes	86	67	49	89
Net income	177	63	191	201
Basic earnings per share	$ 0.39	$ 0.14	$ 0.42	$ 0.44
Diluted earnings per share	$ 0.38	$ 0.14	$ 0.41	$ 0.44
Shares used in computation of earnings per share:				
Basic	455	454	453	451
Diluted	462	461	460	459



Net income

The net loss in 2012 of Amazon is 39 million. The net loss in third quarter is 274 million. It is the first net loss in four years. In 10 seasons' net income (loss), the net income in fourth quarter of 2010 is 416 million and the net income appears to fall. In the first quarter of 2012, the net income is 130 million. The net income in the second quarter of 2012 is only 7 million. The net income in fourth quarter of 2012 is 97 million.

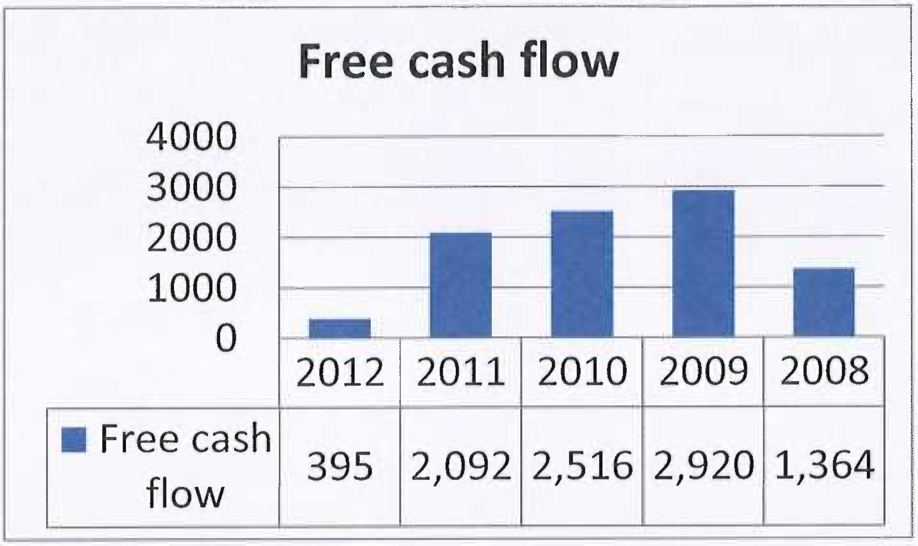


Cash flow

The free cash flow

Up to December 31, 2013, the free cash flow of Amazon drop sharply to 395 million. On year-on-year basis, the free cash flow in 2,092 million in 2011, 2,516 million in 2010, 2,920 million in 2009 and 1,364 million in 2008. Because of the dramatically growth of capital expenditure, the free cash flow drops sharply.

Free cash flow (2)	$ 395	$ 2,092	$ 2,516	$ 2,920	$ 1,364



Amazon SWOT Analysis

Summary of Amazon Chairman's Letter

Amazon now have more than 15 million items in Prime, up 15x since it launched in 2005. Prime Instant Video selection tripled in just over a year to more than 38,000 movies and TV episodes. The Kindle Owners' Lending Library has also more than tripled to over 300,000 books, including an investment of millions of dollars to make the entire Harry Potter series available as part of that selection.

Amazon build automated systems that look for occasions when Amazon have provided a customer experience that isn't up to our standards, and those systems then proactively refund customers.

Amazon also has authors as customers. Amazon Publishing has just announced it will start paying authors their royalties monthly, sixty days in arrears. The industry standard is twice a year, and that has been the standard for a long time. Yet when we interview authors as customers, infrequent payment is a major dissatisfied.

Amazon's heavy investments in Prime, AWS, Kindle, digital media, and customer experience in general strike some as too generous, shareholder indifferent, or even at odds with being a for-profit company.

As proud as the chairman is of their progress and their inventions, he knows that they will make mistakes along the way – some will be self-inflicted, some will be served up by smart and hard-working competitors. Their passion for pioneering will drive them to explore narrow passages, and, unavoidably, many will turn out to be blind alleys.

Strengths

1. **Cost leadership strategy.**

The goal of cost leadership strategy is to produce products and services with a lower cost than the competitors do. The key to achieve this strategy are the economies of scale. For Amazon to succeed with the cost leadership strategy it has to provide the widest range of products to achieve the economies of scale and benefit from the low costs of displaying those products on its online marketplace. In a result, the business became the largest online retailer in the world.

2. **Superior quality services and products.**

Amazon delivers only the best quality services and products. It is reliable, convenient, offers one of the lowest and fastest shipping, the lowest price, many free additional features with its services and has the widest selection of goods. Amazon has a brand reputation for great customer service.

3. **Strategic acquisitions.**

Amazon has been successfully acquiring new firms to bring the new products, services, capabilities, assets and skills to the business. Due to these strategic acquisitions Amazon is now capable of offering cloud services, has developed its information management and customer relationship management skills.

4. **Efficient logistics and distribution.**

Amazon has a number of fulfillment warehouses in each market it operates. The warehouses are geographically spread in each country so the goods could be dispatched faster and with lower cost.

5. **Economies of scope.**

Economies of scope are the savings that come from producing two or more goods (or providing services) at less cost than producing each individually using the same resources and technology. Amazon experiences economies of scope by using its superior IT skills to offer the largest range of products online (instead of offering fewer products). It also uses excess server capacity (which originally were built to support online marketplace) to provide cloud computing services.

Weaknesses

1. **Only online presence.**

Amazon lacks physical presence like retailers such as Wal-Mart and Target. People can see and touch the purchases there and buy them instantly.

2. **Selling at zero margins.**

Many of the products the Amazon offers are sold at zero margins to gain the market share and push the competition out of the market. In a short term, it is a strong tactical move (due to Amazon's cost leadership strategy) but in the long run it only hurts firm's profits. Competitors will adapt and can easily gain their market share back by pursuing differentiation strategy.

3. Negative publicity.

Amazon has recently attracted much negative publicity due to its tax avoidance in the countries (UK and US) where it earns most of its revenues. Amazon is also criticized for poor warehouse conditions for workers, anti-competitive actions, price discrimination and etc.

Opportunities

1. Online payment system.

Amazon could extend its current payments system and introduce the service similar to PayPal. Amazon's payment system would be of great use for mobile buyers who usually by on the go and find it hard to provide bank details or other personal information that is required when purchasing the product. In addition, such service could be used by many other online retailers for a small fee.

2. Release more own brand products and services.

With an access to such large market, Amazon could benefit by releasing more of its own brand products.

3. Increase services and product portfolio through acquisitions.

The company has already acquired many companies to successfully extend its products and services offering.

4. Open more online stores in other countries.

To sustain current growth levels, Amazon could open its online marketplaces in other large and growing economies in Asia and Europe.

Threats

1. Online security.

Amazon stores its online shoppers' personal information, such as bank account details, which is a target for online thefts. The more online customers Amazon has, the more attractive as a target it becomes.

2. Lawsuits.

The business has already attracted much negative attention from UK and U.S. authorities for tax avoidance and is subject for litigations and fines. Lawsuits are costly and consume time.

3. Strategic alliances.

Although Amazon is a massive online shopping mall and can't be easily surpassed by small competitors, it faces serious challenges from strategic alliances. For example, the strategic alliance between Apple and e-books content providers allowed the content providers to demand that Amazon would sell e-books for higher price or that they will sell their e-books through Apple store only. Without the strategic alliance, content providers were unable to compete against Amazon's bargaining power.

4. Legislation against tax avoidance.

There are growing concerns over how huge multinational companies, such as Amazon, avoid paying taxes for the countries they operate in. Eventually, governments will pass a legislation requiring that all companies would pay a fair share of taxes. In this case, Amazon's profits would be significantly affected.

5. Regional low cost online retailers.

Regional low cost online retailers could out rival Amazon on faster and cheaper shipping, localized product offering and better knowledge about home market.

Conclusion

Today's greatest companies weren't built overnight. Put to the test, the success of Amazon.com (Nasdaq: AMZN) teaches us not to underestimate the value of long-term thinking. Here's why our team think the stock of Amazon deserve to buy. Amazon is the world's largest online retailer. At first glance, it may seem that the company's going in too many directions at once. But if you take a closer look and you'll see an arrangement of innovative businesses ready to burst.

Amazon's come a long way from its days selling books online. Online shoppers in the U.S. will spend an estimated $327 billion in 2016, according to Forrester Research -- that's a 62% increase from $202 billion a year ago. According to the lead position in this evolving-commerce space, Amazon's core business will get benefits from it.

Additionally, Amazon Prime is the company's first step drug. The program attracts customers to spend more (and more frequently) because Amazon offers free two-day shipping on an unlimited number of deliveries for just $79 a year. True, Amazon Prime is currently a drain on the company's balance sheet. However, the program is an investment in the e-tailer's future that will pay off down the road. In 2011, it expanded Prime to include unlimited streaming videos. To top things off, each of Amazon's new Kindle Fire tablets come with a free Prime trial -- hook, line, and sinker.

Amazon attracts hundreds of thousands of customers to its website every day. However, the stock's been dumped lately on worries that the business is burning through cash too quickly. Now, I'd agree if Amazon were blowing money on shoddy products or questionable acquisitions -- but that's not the case.

Not unlike Apple (Nasdaq: AAPL) , the e-tailer is pouring cash into its massive media ecosystem. Apple's iTunes creates a network effect for the Mac maker that helps keep customers loyal to its brand. Similarly, Amazon's cloud lets customers download apps, songs, or books, and stream movies to their devices. Because these items are then stored in the cloud, users must keep using Amazon to access those purchases in the future.

By heavily investing in its infrastructure, Amazon is making the decision to value market share over short-term profit gains. This strategy will help the e-tailer triumph over competitors in the future. In my opinion, buy the stock because it will only continue to climb higher from here.

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