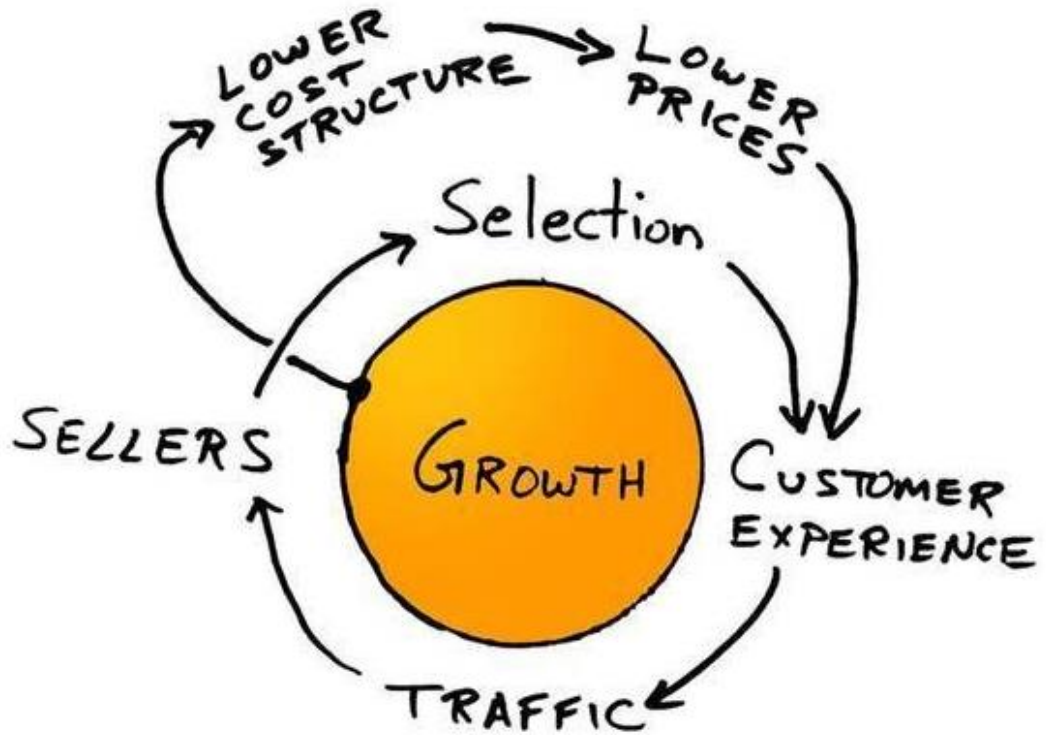


Amazon: Growth like a flywheel

Amazon's law of flywheel



CASH Research
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6 Aug 2018

Source: Amazon

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From (1) investment to drive traffic, (2) sellers getting attracted, (3) improvement in selection and convenience, (4) better customer experience which in turn increase traffic –The whole system grows. As a result of the spinning, Amazon is able to lower the cost structure which allows them to lower prices, also further enhancing the customer experience. So the flywheel spins even faster as it grows; the growth itself is an accelerator. – Amazon's 'Virtuous Cycle'

It is right to say that we are still at "day one" in terms of the impact of the Internet on society, and that his company is still in the "early days" of its business lifecycle. – Jeff Bezos, chairman and CEO of Amazon

The market leader: Amazon.com, is the world leading online retailer, manufacturer of electronic book readers, and Web services provider. Recently, Amazon has expanded its empire by (1) extension of Prime ecosystem with stronger customer stickiness; (2) third party seller growth (which represents a way to de-risk penetration into to new countries); (3) enhancing the speed of delivery to customers with additional distribution centers and (4) eye-catching growth in larger underpenetrated categories (including apparel, consumer packaged goods, office).

Prime Ecosystem to build a loyal customer base: Amazon initially unveiled Prime in 2005, offering **unlimited superior shipping service**. Prime membership today also includes a **streaming video service** rivaling Netflix and Hulu, **streaming music service** rivaling Spotify and Pandora, **photo storage** rivaling iCloud & Google Photos, and more. These benefits greatly improve subscriber retention. **That's why we think Prime is a key driver of the Amazon flywheel in generating good user experience.**

Backed by Fulfilment by Amazon (FBA) to further integrate the vertical supply chain: Strong e-commerce logistics system is a major key for the success of Prime. Amazon is an e-commerce platform company backed up by growing logistics network, with warehousing and logistics investment being one of Amazon's major costs. Amazon builds logistics centers, developed drones, storage robots, fleets, and shipping systems, which are all designed to speed up the delivery process, in order to enhance customer experience and optimize cost-effectiveness, and create Amazon FBA (Fulfilment by Amazon).

Big data to fuel advertising rev: Amazon has taken advantage of the e-commerce with huge amount of transaction data (Google being its largest competitor in search engine). We think no one can transcend Amazon from the perspective of knowing customers' need with consumers' search behavior data. We think advertisers are more willing to spend their advertisement budgets on Amazon because of the easiness in converting search clicks to actual sales on its e-commerce platform.

Amazon Web Services: AWS accounted for near 70% of the company's total operating income currently. We like AWS will continue to benefit from its

first-mover advantage, broadest cloud services portfolio and strong innovation among developers.

Initiate “Buy” with target price of USD1,950: Our price target of USD1,950 is based on sum-of-the-parts analysis. We believe this methodology appropriately attributes value to the company’s large, fast-growing, and profitable AWS segment. We apply a 1.7x EV/Sales multiple on 2019E Retail, justified as average global retailer peer. We apply a 21.8x EV/EBITDA multiple on 2019E AWS , which is the average of SaaS global software industry.

Figure. Amazon and its peer valuation and earning forecast (Retail)

Equity	Stock Code	Price (\$LC)	TP	上行%	18EPSGth	19EPSGth	2018 PE	2019 PE	2018 ROE	2019 ROE	2018 PB	2019 PB	EV/Sales
Global Retail													
Amazon	AMZN US Equity	1823.29	1950.00	6.9%	150.60	39.94	71.97	51.43	21.71	23.46	21.23	14.99	3.77
Home Depot	HD US Equity	195.64	NA	NA	26.68	8.06	20.70	19.16	869.96	606.55	117.57	115.01	2.30
Lowe's Comp	LOW US Equity	97.63	NA	NA	24.19	12.07	17.91	15.98	71.62	74.83	12.46	11.60	1.30
Target Corpor	TGT US Equity	81.45	NA	NA	12.82	3.09	15.33	14.87	24.07	24.39	3.66	3.51	0.73
AutoZone	AZO US Equity	721.38	NA	NA	13.24	12.98	14.46	12.79	-96.28	-110.78	NA	NA	2.11
Advance Auto	AAP US Equity	144.68	NA	NA	26.93	13.50	21.23	18.70	14.09	14.58	2.77	2.56	1.16
Walmart	WMT US Equity	89.60	NA	NA	7.33	3.37	18.89	18.27	17.65	21.39	3.41	3.33	0.60
	Average				37.40	13.29	25.78	21.60	131.83	93.49	26.85	25.17	1.71
	Median				24.19	12.07	18.89	18.27	21.71	23.46	8.06	7.55	1.30

Source: Bloomberg, CASH

Figure. Amazon and its peer valuation and earning forecast (Cloud)

Equity	Stock Code	Price (\$LC)	TP	Upside	18EPSGth	19EPSGth	2018 PE	2019 PE	18 EV/EBITDA	19 EV/EBITDA	18EBITDAGth	19EBITDAGth
Global Software												
Amazon	AMZN US Equity	1823.29	1950.00	6.9%	150.60	39.94	71.97	51.43	28.03	20.85	58.38	33.10
Kingdee	268 HK Equity	8.79	NA	NA	5.98	34.19	65.60	48.88	30.34	25.41	5.70	17.87
Yonyou	600588 CH Equity	23.80	NA	NA	70.44	34.46	67.46	50.17	39.97	30.86	NA	27.74
Ygsoft	002063 CH Equity	5.75	NA	NA	25.80	27.24	22.30	17.55	NA	NA	NA	NA
Neusoft	600718 CH Equity	12.63	NA	NA	-50.00	14.88	29.21	25.43	NA	NA	-42.37	30.56
Chanjet	1588 HK Equity	11.20	NA	NA	-68.95	67.65	28.63	17.08	NA	NA	NA	9.89
Inspur	596 HK Equity	2.78	NA	NA	NA	13.33	18.53	16.35	NA	NA	NA	NA
Sage	SGE LN Equity	660.00	NA	NA	3.49	9.42	20.06	18.33	14.62	13.13	6.16	8.95
SAP	SAP US Equity	115.71	NA	NA	NA	11.78	22.72	20.32	NA	NA	0.58	15.21
Oracle	ORCL US Equity	48.47	NA	NA	7.95	7.30	14.39	13.41	9.77	9.23	28.98	5.03
Salesforce	CRM US Equity	141.04	NA	NA	71.26	17.30	61.00	52.01	NA	25.20	32.34	25.87
Intuit	INTU US Equity	205.15	NA	NA	25.33	17.57	37.12	31.57	23.54	20.60	11.36	11.12
Workday	WDAY US Equity	129.16	NA	NA	22.14	31.64	102.67	78.00	51.89	37.90	41.32	34.61
Linx	LINX3 BZ Equity	18.40	NA	NA	-17.83	24.07	29.92	24.12	15.53	13.37	19.16	16.08
	Average				20.52	25.05	42.26	33.19	26.71	21.84	16.16	19.67
	Median				15.04	20.82	29.56	24.77	25.78	20.85	15.26	16.98

Source: Bloomberg, CASH

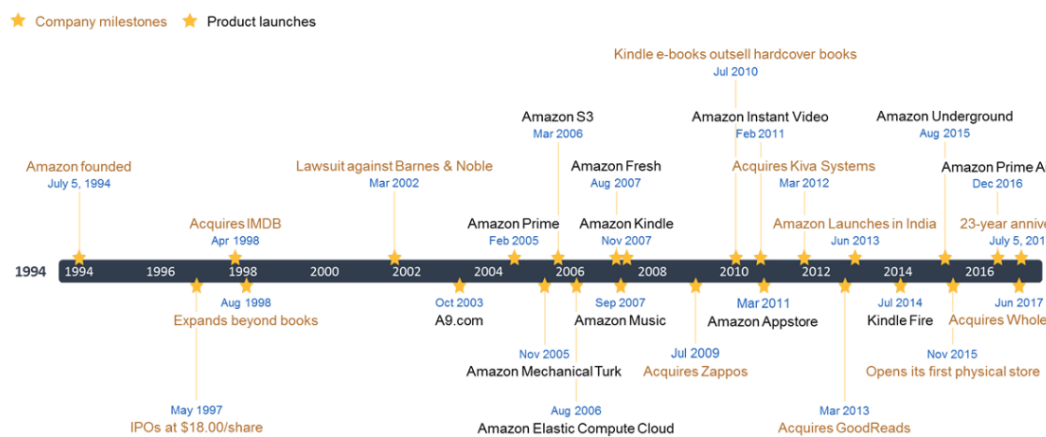
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Introduction

Amazon.com, is the world leading online retailer, manufacturer of electronic book readers, and Web services provider. Its headquarters are in Seattle, Washington. The Company is an Internet-based enterprise that sells books, music, movies, housewares, electronics, toys, and many other varieties of goods, either through third parties and its own brand. Its Web services business includes renting data storage and some computing resources (cloud computing, its users include Netflix, etc). Recently, Amazon has expanded its empire by (1) extension of Prime ecosystem with stronger customer stickiness; (2) third party seller growth (which represents a way to de-risk penetration into to new countries); (3) enhancing the speed of delivery to customers with additional distribution centers and (4) eye-catching growth in larger underpenetrated categories (including apparel, consumer packaged goods, office). For example, apparel is a big category that remains highly fragmented, Amazon can enter the market easily and leverage its competitiveness in price and fast delivery.

Figure. Development of Amazon’s empire



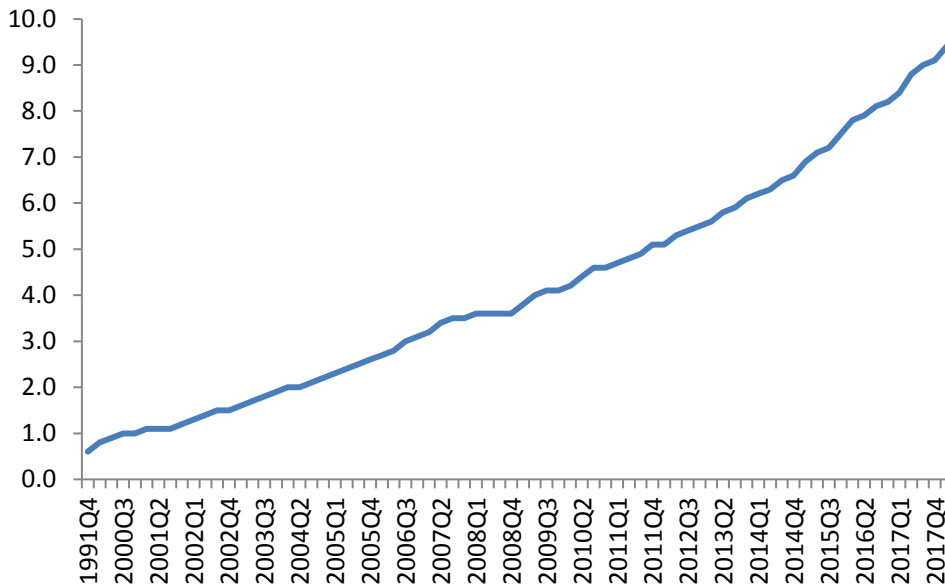
Source: Amazon, CASH

Amazon started as an online bookstore, but now Amazon is a giant in all areas of e-commerce, ranging from fashion to groceries, boosted by a strong Marketplace network of third-party sellers. Amazon is the biggest e-commerce platform, accounting for 49% of total US market. In terms of popular categories, consumer electronics and tech (25%) continue to be the leading product category, followed by (2) apparel and accessories (15.4% in 2018), (3) health, personal care(6.2%) and beauty and (4) food and beverage (1.8%). In the first quarter of 2018, there are USD1.2 trillion total in retail sales, 9.3%

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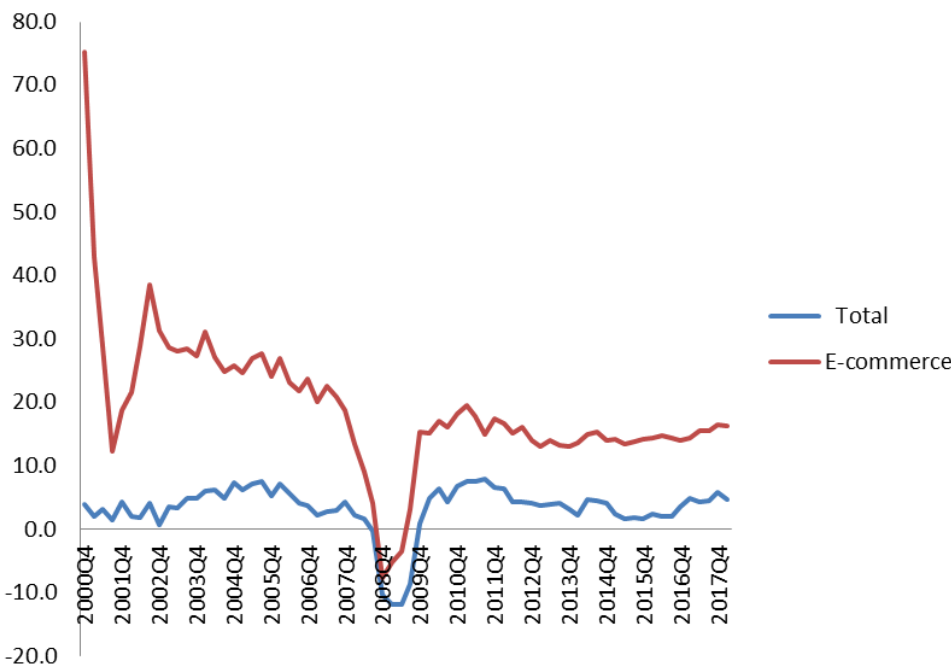
came from e-commerce. E-commerce has been outperforming the total retail sales for decades (16.4% vs 4.7% in 2018Q1), we continue to like the future of E-commerce given the recent AI development (enhanced advertisement-targeting) and increase in cyber security level.

Figure. US E-Commerce Sales as Percent of Retail Sales since 1991Q4



Source: US Census Bureau, CASH

Figure: YoY growth of US Retail vs E-Commerce Sales since 1991Q4



Source: US Census Bureau, CASH

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Recent development

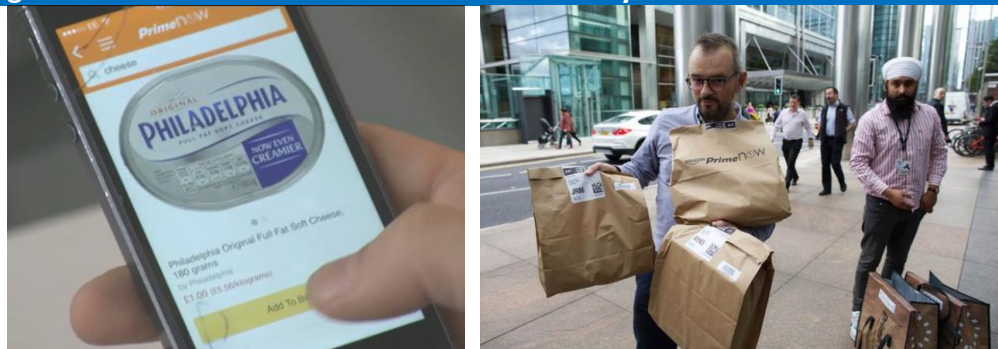
Shaping the ecosystem within grocery sector: Since AmazonFresh was introduced in 2007, Amazon has launched a series of initiatives with the goal to penetrate into the grocery sector. Amazon currently has five key offerings: 1) **AmazonFresh**, which offers grocery delivery for more than 500k items in Seattle, Northern California, Southern California, New York, and Philadelphia. AmazonFresh membership costs USD14.99/month, only available to existing Prime members; 2) **Prime Now**, which has more of a consumer packaged goods and is available in more than 30 US cities with unlimited free two-hour delivery on >25k items with orders more than USD40 (over USD60 for international delivery). Amazon partners with some third-party grocers; 3) **Prime Pantry**, which offers non-perishable groceries and household products; 4) **AmazonFresh Pickup**, which offers Prime members choose when and where they want to pick up the order freely; and 5) **Amazon Go**, a partially-automated grocery store, with customers able to purchase products without using a cashier or checkout station

Figure. Amazon Fresh



Source: Amazon, CASH

Figure. Prime Now - one-hour fresh food delivery service



Source: Daily mirror, CASH

Figure. Prime Pantry



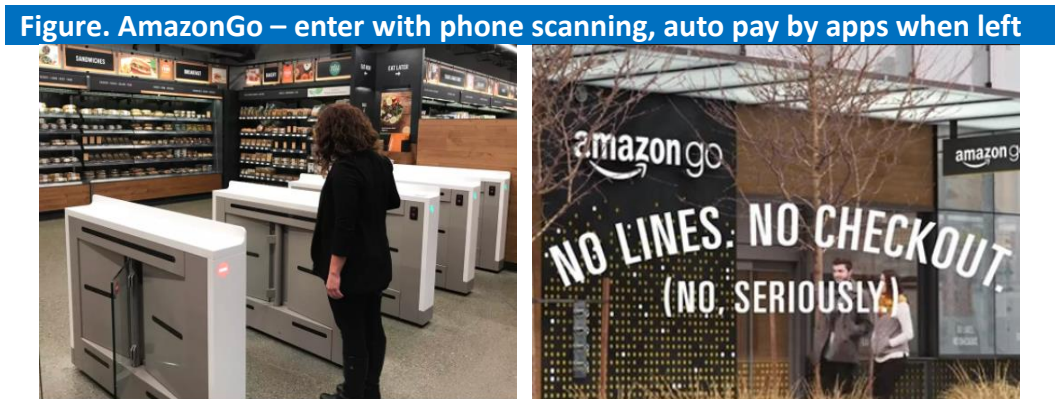
Source: Amazon, CASH

Figure. Amazon Fresh pickup



Source: Amazon, CASH

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Source: Amazon, CASH

This is backed by WFM partnership: Amazon and Whole Foods Market (WFM) announced they have entered into a merger agreement where Amazon was the acquirer. We think that can increase user stickiness through 3 ways: **(1) Fast expansion of online distribution:** While most grocer brand names are regional, we believe Amazon can expand online distribution in a fast pace for Whole Foods' 365 Everyday Value private brand (products that carry the brand of the retailer) which was a strong national brand (produced by, widely distributed by, and carry the name of the manufacturer). Also, **(2) synergy from leveraging the logistics network:** WFM's physical stores will help increase density for AmazonFresh for online ordering and local delivery, serving as local hubs, improving last mile and delivery capabilities for WFM, which offers local delivery in select cities via Instacart (competitor of Amazon which provides same-day grocery delivery service). And **(3) physical retail transformation:** We discover Amazon Bookstores and the Amazon Go store in Seattle provides 'online + offline' experience to clients, in which convenience and more perfect information are the keys to raise shoppers' buying will.



Source: Seeking Alpha, supermarketnews.com, CASH

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Potential entry into travel industry but takes time: Amazon can capture market share via 3 ways: (1) Amazon can offer hotels lower commission rates. (2) Also, considering that price/experience comparison to customers is especially important in online travel business given lower purchase frequency and high expenditure per trip of customers, we think Amazon platform is good at gaining customers' attention using its leading scale and ability to use data to drive conversion. (3) We also see the potential partnerships, or acquisitions could enable AMZN to move faster.

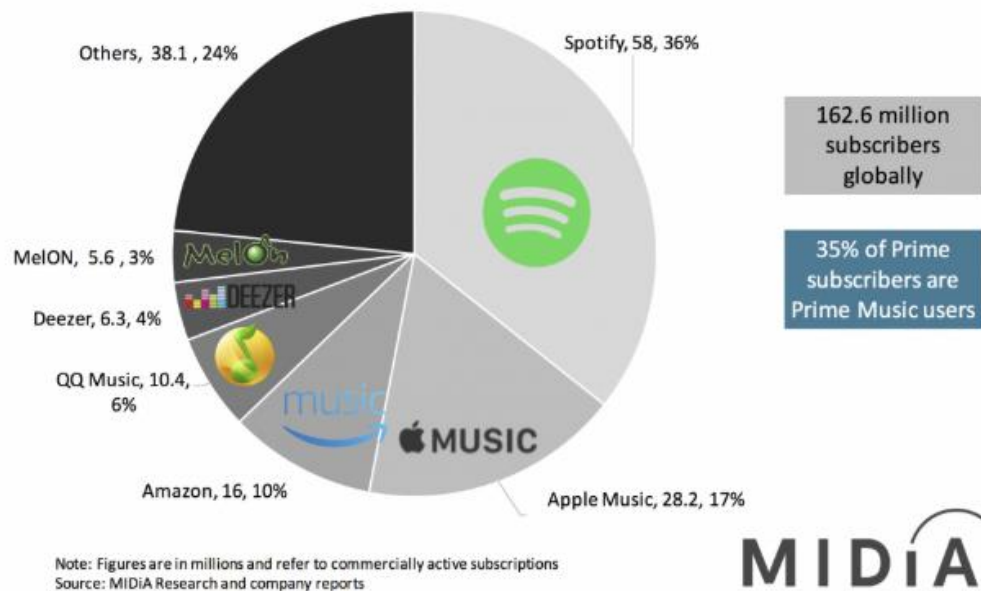
Another spot maybe the healthcare new area: Amazon, Berkshire Hathaway and JPMorgan Chase & Co. announced a partnership the aim to reduce healthcare costs over time. We think this new company is more conceptual than real, the management team is still waiting to be formed with no actual headquarter and operational details, implying no solution been built yet. Initially, the new company will be focused on technology rather than insurance. However, participants are all well-respected names, with expertise in technology, underwriting, and finance, there will be a future potential for the pharmacy benefit manager (PBM) services. However, without experience in healthcare, it takes a longer time for material monetarization. We see a long-term opportunity for Amazon on pharmacy & drug distribution (especially generic drugs) given (1) higher margin vs retail, (2) recurring revenue, and (3) leveraging on the Amazon's delivery investments to add value.

Established customer base in music ecosystem: Total music subscribers globally grew to 162.6 million in June 2017, up 30 million from 132.6 million at the end of 2016. Amazon is now the third largest streaming music service globally with 16 million subscribers as of June 2016, across Amazon Prime Music and Music Unlimited. This is impressive as it is only in 4 markets (US, UK, Germany, and Japan), compared to Apple (No.2 with 28 million paying subscribers) in 115 countries and Spotify (No.1 with 58 million paying subscribers) in 63 countries. We see Amazon as a 'black horse' after years of quietly building a customer base.

Figure. Amazon is now the third largest streaming music service globally

Amazon Has Fast Become The 3rd Largest Music Subscription Service Globally

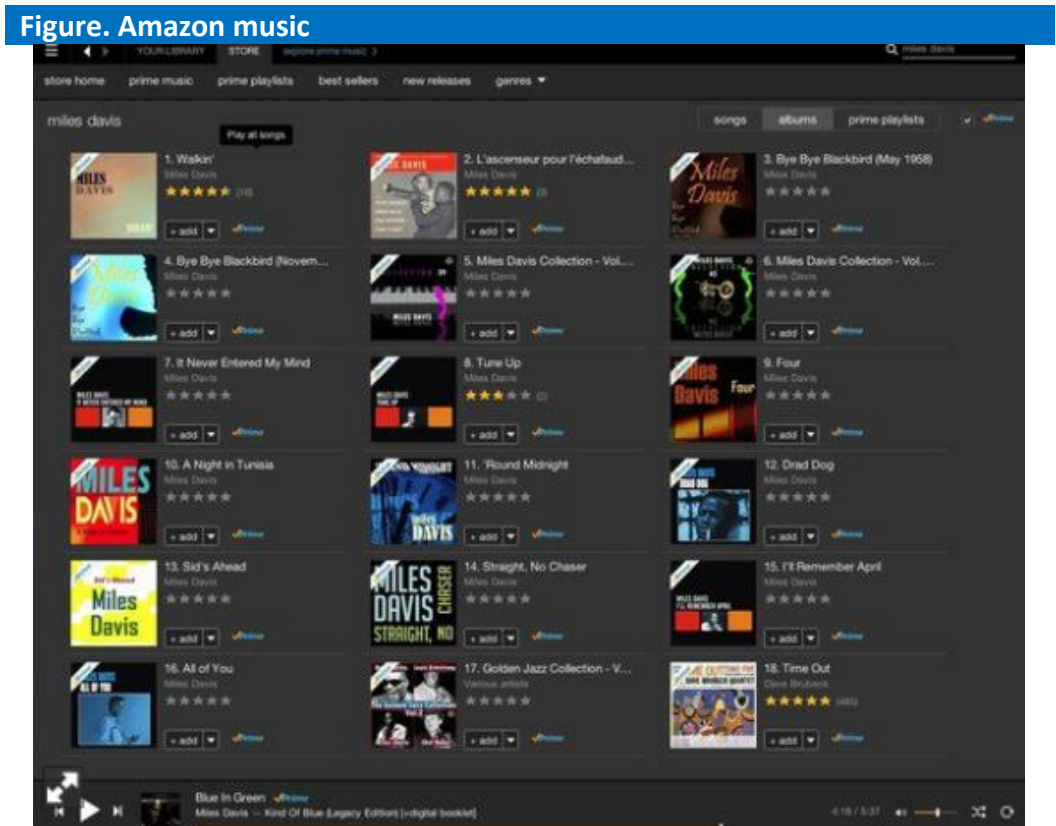
Global Streaming Music Subscribers, June 2017



Source: MIDiA research, CASH

All aims to build more Prime members: We believe Bezos's another major investment focus is Prime Media's subscription service. The company is investing Prime Video's premium original audio and video content, competing with Netflix. 'Manchester By the Sea' by Amazon Studio won the Oscar, we think Amazon's intention in music and video development is to trigger more consumers to join Prime members to enhance e-commerce sales.

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Source: teehive.com, CASH

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The flywheel growth engine

1. Prime as the core driver

Ecosystem to build a loyal customer base: Amazon initially unveiled Prime in 2005, offering **unlimited two-day shipping service** on ~1 mn items for USD79/year. After more than 10 years of investments and innovations, Prime has expanded, covering wide variety of products (Now 2 payment choices: USD12.99/month or USD99/year). Prime membership today also includes a **streaming video service** rivaling Netflix and Hulu, **streaming music service** rivaling Spotify and Pandora, **photo storage** rivaling iCloud & Google Photos, and more. These benefits greatly improve subscriber retention. **That's why we think Prime is a key driver of the Amazon flywheel in generating good user experience.** On the other hand, Prime delivers various features that we believe it would be very difficult for almost all companies to replicate. While growing the Prime offerings in terms of product and geographical coverage (increasing its selection of available two-day free shipping items or even one-day delivery, expanding geographic coverage for same-day delivery), Amazon is adding more new service to prime members, creating a **high entry barrier due to higher user stickiness.**

Figure. Prime benefits and the Amazon ecosystem

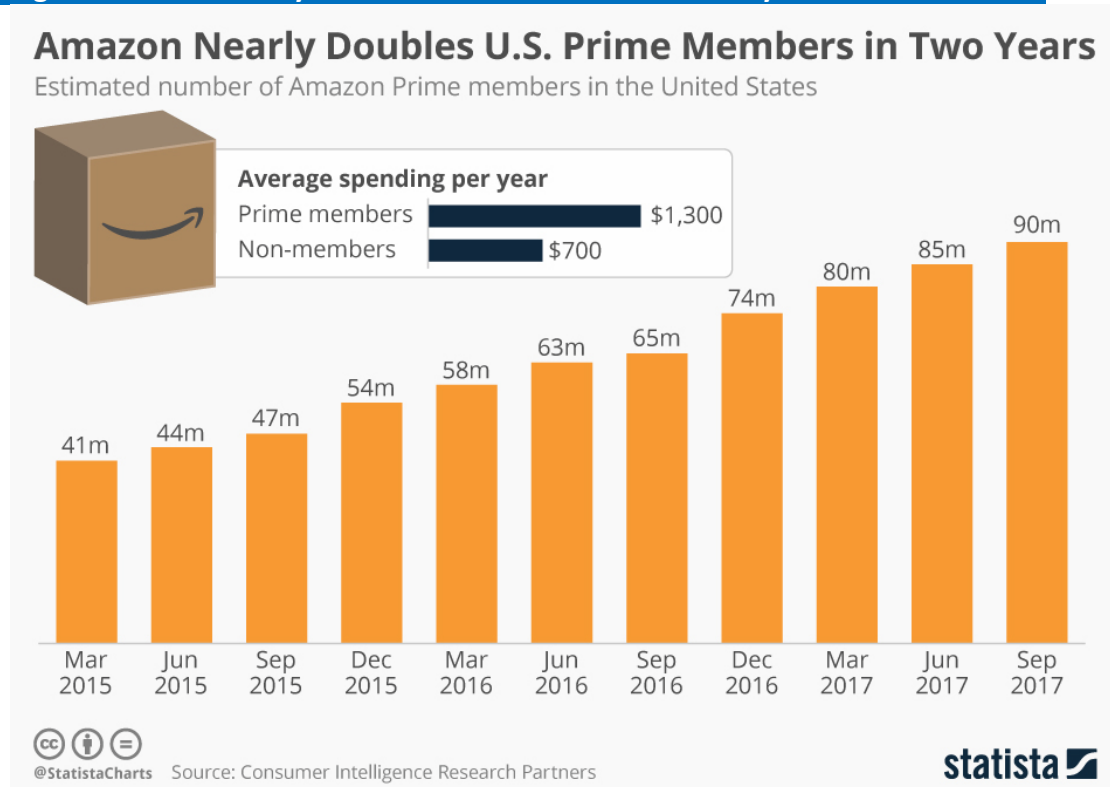
Shipping benefits	
FREE Two-Day Shipping	Delivery on eligible items to addresses in the contiguous U.S. and other shipping benefits
FREE Same-Day Delivery	Delivery in eligible zip codes
Prime Now	Get FREE 2-Hour Delivery on thousands of items
Streaming benefits	
Prime Video	Inlimited streaming of movies and TV episodes for paid or free trial members in the U.S. and Puerto Rico
Amazon Channels	Watch your favorite shows and movies from HBO, SHOWTIME and STARZ channels (USD4.99-14.99/month for Prime members)
Prime Music	Unlimited, ad-free access to hundreds of Prime Playlists and more than a million songs for members in the U.S. and Puerto Rico
Amazon Music Unlimited	Prime members can get discounted Amazon Music Unlimited monthly plans and there are annual plans available exclusively to Prime members
Twitch Prime	Members get exclusive discounts on physical games pre-orders and new releases
Shopping benefits	
Amazon Prime Rewards	Eligible Prime members earn 5% back every day on all Amazon.com purchases with Prime credit Card
Prime Pantry	Prime members in select regions can shop for groceries and household products in everyday sizes and pay an additional delivery fee
Amazon Fresh	Prime members in select regions can pay an additional monthly membership fee to receive FREE shipping on all Amazon Fresh orders of \$50 or more, or pay a flat delivery fee for each order they place under \$50
Prime Early Access	Get 30-minute early access to Lightning Deals on Amazon.com
Amazon Elements	Access to Amazon Elements products, Amazon's own line of everyday essentials
Amazon Family	These include up to 20% off diapers, baby food, and more through Subscribe & Save and 15% off eligible products from your baby registry
Amazon Dash for Prime	Never run out of your favorite products with Amazon Dash Button
Reading benefits	
Prime Reading	You can borrow books, magazines, and more from the Prime Reading catalog
Amazon First Reads:	Early access for members in the U.S. to download a new book for free every month from the Amazon First Reads picks
Audible Channels for Prime	Unlimited listening to original audio series and playlists handcrafted for every interest
Washington Post Free Trial	Enjoy unlimited access to The Washington Post with a six-month free trial
Others	
Prime Photos	Secure unlimited photo storage and enhanced search and organization features in Amazon Drive for you and the members of your Family Vault

Source: Amazon, CASH

Revenue per user side: The core of Amazon's current e-commerce strategy is "Prime", which is to attract consumers to join Prime members, paying an annual fee, using more superior Amazon services with lower prices (including fast arrival free shipping, Prime exclusive discounts and offers, Music and video content subscription services, etc.). This helps enhance consumer experience and user stickiness, in turn stimulating consumers to spend more money on Amazon. Amazon Prime members spend much more than non-Prime members (Prime members spend an average of USD1,300/year vs non-Prime USD700/year). Amazon announced that US Prime membership prices are increasing from USD99/year to USD119/year, which will be a positive earning driver until mid-2019.

Number of user side: On the other hand, the number of Prime members has soared. According to CIRP’s findings, Amazon Prime had 90 million members in the United States at the end of September 2017, up from around 47 million in September 2015 (2-year CAGR ~8%). As of September 2017, 63 percent of Amazon online shopping users were also subscribers to the Amazon Prime service, also showing an accelerating penetration. We see **there is still ample room for member growth**. As we see that fully 88% of 18-34 years olds in the US prefer to shop on Amazon over other online retailers (vs. 67% of >50 years old), we believe more and more consumers will continue to shift to online retailers in next 10 years and join as Prime members, number of AMZN members still has room to improve. Driven by the price/experience provided by Prime, number of Prime members may even grow faster, mainly bought by internationalization (especially when more than 50% of US households are prime members, we guess it may be nearly saturated).

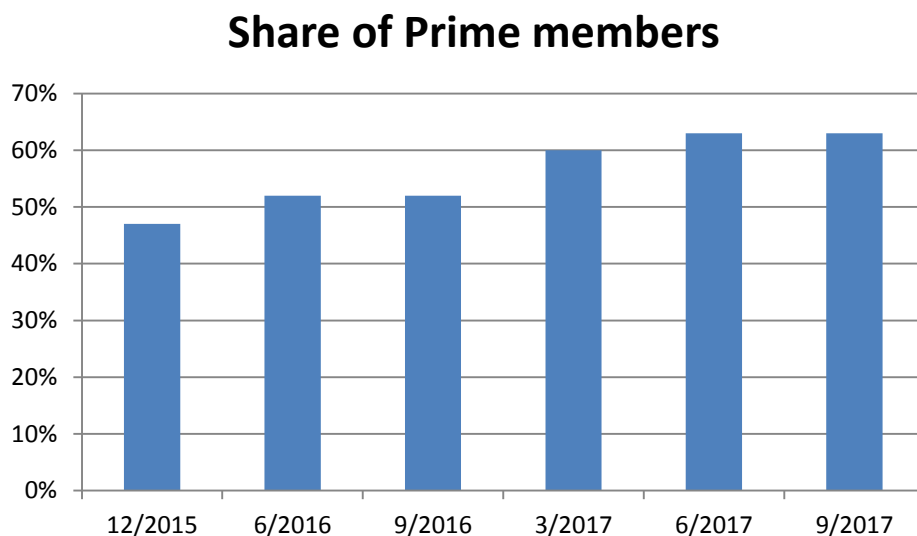
Figure. Amazon nearly doubles U.S. Prime members in 2 years



Source: marketing charts, CASH

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Figure. Share of Prime members



Source: Statista, CASH

Figure. Preference for Shopping on Amazon and Alibaba



Source: marketing charts, CASH

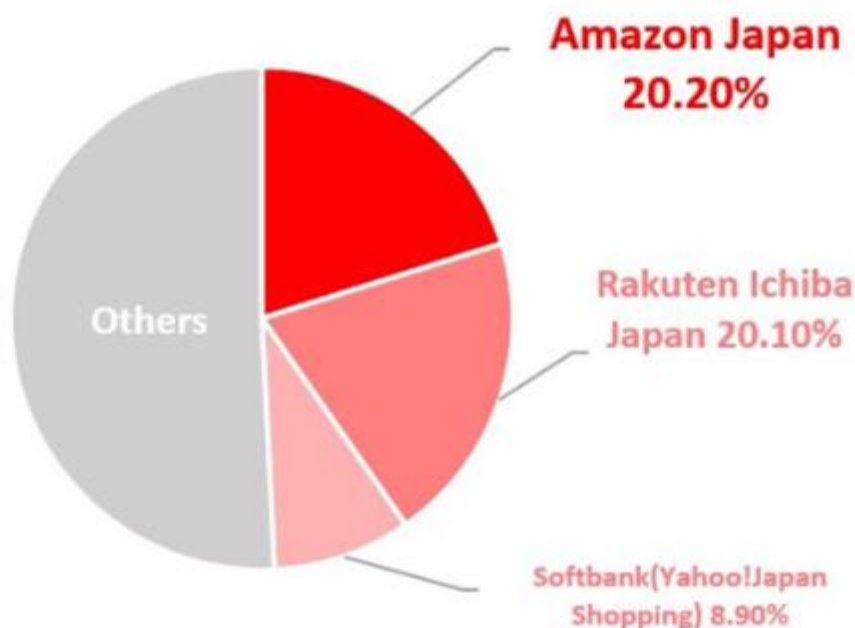
Go Global to drive Prime growth: We think there is huge potential for Prime member growth, especially in international markets. Amazon launched Prime in India, Mexico, and China over the past year, and also expanded its Prime Video subscription option to more than 200 countries, introduced a discounted monthly Prime offer for customers receiving government assistance (USD5.99/month). Also Amazon launched Amazon Music Unlimited in the US, UK, Germany, and Austria. Though different countries have different labor cost and delivery pricing structure, we believe Amazon Prime can grow strongly.

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P.S: But we think the competition is fierce outside US, for example Amazon finds it difficult to compete with Alibaba and JD.com in China (We see Alibaba also difficult to expand in US as Amazon cater better to regulators until it has cleaned up the counterfeit issue coupled with massive logistics network), while Snapdeal and Flipkart are the strong competitors to Amazon in India. Also, Japan is the 2nd biggest foreign market for Amazon following Germany. Yahoo Japan and Rakuten also represent biggest threats with slow penetration rate of prime members (by NTTCom Research claims that just 16.6% of Amazon users in Japan are Prime members VS 63% of Amazon customers in the US). Line's new Clova smart speakers also compete with the Amazon's echo, making Amazon difficult in building up its ecosystem. Domestically, Target, Macy's and Walmart also offered 'Black Friday in July' deals (discounts also for non-members) vs. Amazon's Prime day.

Figure. Amazon's competitors in Japan in 2016

Shopping Mall Website Share



Source: Jetro Data, CASH

711 Prime Day more than just a 1-Day revenue spike: We think the true benefits of Prime Day may include (1) better gauging customers 2H demand, (2) peak-day test to ensure fulfillment centers (where goods are stored and packed for shipment) and logistics can run smooth during the holiday season

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and (3) providing a gimmick to motivate 3P sellers to join its platform, (4) driving Amazon in-house device sales; and (5) bringing more new Prime members and (6) better capture back-to-school sales.

Prime Day enhancement: Prime Day's duration has extended into 36 hours from 30 hours, 17 countries from just 13 countries, and Amazon has met or exceeded its expectations in other dimensions, especially **for the advertising and subscription businesses, which currently brings little revenue contribution, are the fastest-growing segments in the future: (1)**

Transformation to more Prime members with the number of new members on 16 July reaching the highest in history, implying an increase in per user value; **(2) Sell with wider channels** given Whole Foods's participation in Prime Day for the first time with one-week promotion; **(3) Promote self-produced hardware like Echo/Fire, popularizing Alexa virtual assistant to family usage.**

(The world's best-selling items on the day were Fire TV Stick with Alexa Voice Remote and Echo Dot/ the Fire TV series were sold millions of pieces/the recently launched Echo Show and Echo Spot also broke the day sales record/ the newly acquired smart doorbell brand Ring broke the day sales record/ the newly launched Amazon Cloud Cam became the best-selling home security camera in history, with more than one million smart home products sold); **(4) Promote advertising business.** This year, more third-party brands participated in the promotion, including big brands such as Philips and Bose, as well as small and medium-sized enterprises such as Simply Gum (the company disclosed that the small and medium-sized merchants Prime Day had a turnover of more than 1 billion), and they were more active in advertising; **(5) Promote subscription services.** The most discounted items in the US are Amazon Music (USD1 for 4 months with original price equal to USD8 per month) and Kindle Unlimited (USD1 for 3 months with original price equal to USD10 month).

2. Growing e-commerce logistics

Backed by Fulfilment by Amazon (FBA): Strong e-commerce logistics system is a major key for the success of Prime. Amazon is an e-commerce platform company backed up by growing logistics network, with warehousing and logistics investment being one of Amazon's major costs. Amazon builds logistics centers, developed drones, storage robots, fleets, and shipping systems, which are all designed to speed up the delivery process, in order to

enhance customer experience and optimize cost-effectiveness, and create Amazon FBA (Fulfilment by Amazon).

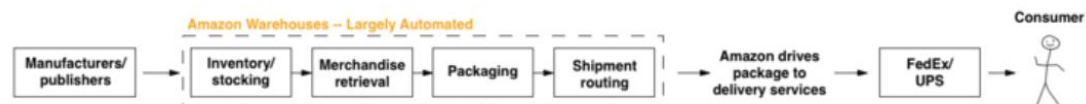
Figure. Amazon's fulfillment



Source: Sellbrite, Barnum & Celillo Electric, Inc., CASH

Accelerating fulfillment and data center footprint: Fulfillment (fulfillment & data centers) sq. ft. was up 44% in 2017 to 230mn sq. ft., showing an acceleration when compared with 33% growth in 2016), faster than Amazon's 25% unit growth in 2017. Amazon also added 21.3mn sq. ft. of **physical retail space**, largely through Whole Food Market (WFM). For AWS, facilities include 6.2mn and 4.0mn leased & owned sq. ft., representing 26% YoY growth in 2017, up from 21% YoY growth in 2016. AWS operates 52 **availability zones** in 18 regions (vs. 42 AZs in 16 regions at 2016). AWS plans to add 12 additional AZs in 4 regions by early 2019.

Figure. Amazon's supply chain



Source: samseely.com, CASH

3. Platform+Hardware to build a closed loop ecosystem, and expand life service business

Amazon Echo to stimulate consumption: Amazon is not only an e-commerce platform, but also a hardware manufacturer. Kindle e-book reader is one of Amazon's most influential products. It has disrupted the whole book market, allowing American e-book sales to surpass physical books. Its smart voice home assistant Echo series products occupied an absolutely dominant position.

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According to Consumer Intelligence Research Partners, around 70% of home voice assistant devices are from Amazon, with Google Home holding nearly all of the remains currently. Amazon can collect more valuable user information through the Echo series products, in turn helping them to understand customers' habits and inferring their preferences and needs, so that **consumers can be more convenient and more accustomed to use Amazon for online shopping by voice**. For example, Echo's built-in Alexa voice assistant can also connect to third-party services, which they call "Alexa Skills", **to call cars, order pizzas, ask for the weather, listen to news, and control home IoT devices**. We believe smart voice home device will become an indispensable core device for families in the future, early movers like Amazon and Google can benefit, penetrating into life service market.

Figure. Amazon Echo



Source: Amazon, CASH

4. Strong datasets

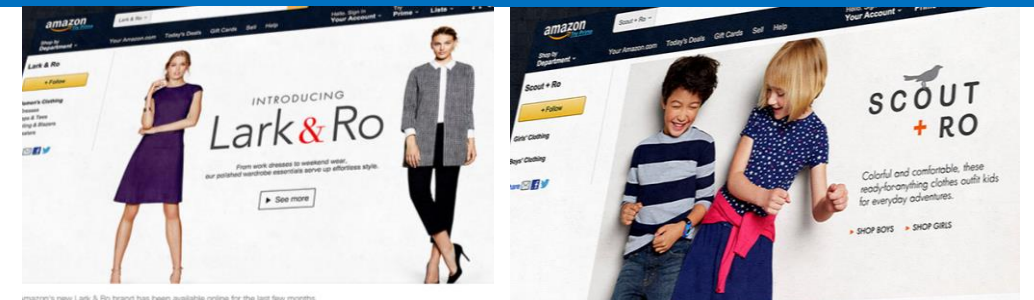
Big data to fuel advertising rev: Amazon has taken advantage of the e-commerce with huge amount of transaction data (Google being its largest competitor in search engine). We think no one can transcend Amazon from the perspective of knowing customers' need with consumers' search behavior data. We think advertisers are more willing to spend their advertisement budgets on Amazon because of the easiness in converting search clicks to actual sales on its e-commerce platform. With the use of big data, AI and cloud analysis, we expect more customers will get incentivized to buy on

Amazon, bringing more advertising budgets/products to Amazon, which may in turn stimulate consumption with more product information and selections. This is like a 'Virtuous Cycle' driving a flywheel.

Big data as the fuel, self-owned brand as the engine: Amazon has the data of products with good sales, better profit, and high consumption frequency. When it comes to something highly profitable, Amazon can directly build its own brand to place orders with manufacturers. And Amazon can increase its success rate with strong promotion on its own platform. For example, for daily necessities like batteries, Amazon built its own Amazon Basics brand to sell these commonly used products. On the other hand, when Amazon discovered the high margin of fashion products, Amazon launched several own sub-brands under Amazon Fashion to enter the fashion field, and even created Amazon's exclusive fashion show "Style Code Live." That means Amazon is trying to cut into any unfamiliar areas with the use of its own big data, which may be a big opportunity in the long run given its knowledge in understanding customers' preference (through internet forum, customer feedback, search engine, readers' recommendations, etc).. Its own devices, including Echo, Fire TV, Kindles, etc are also bright spots.

P.S: Amazon has debuted two private label denim lines, Hale and Denim Crush. But for now, (1) Amazon has yet to be trusted by consumers as a fashion authority or gained sufficient customer recognition and (2) Amazon's private label lines are generating too little sales volumes.

Figure. Lark & Ro (woman brand) / Scout + Ro (Children) controlled by Amazon



Source: money.cnn.com, CASH

5. Amazon Cloud Services

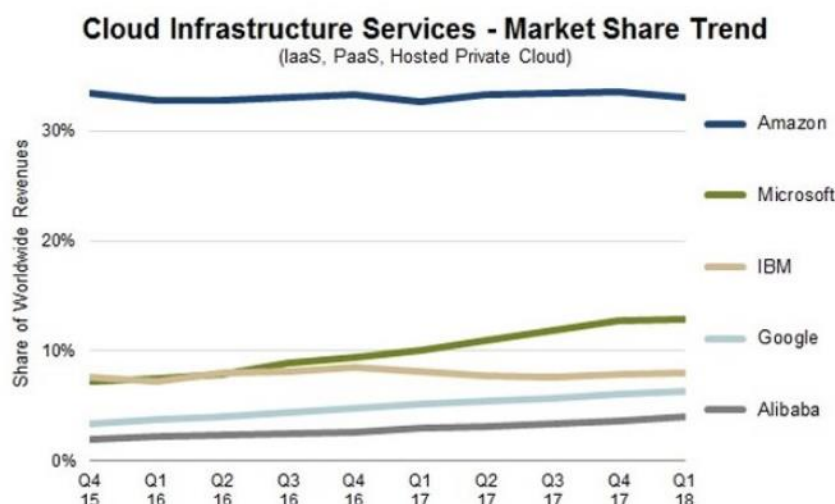
Amazon Web Services: AWS accounted for near 70% of the company's total operating income currently. We like AWS will continue to benefit from its

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first-mover advantage, broadest cloud services portfolio and strong innovation among developers. Its efforts to lower the barriers for enterprises wanting to use machine learning and AI services had resulted in a 250% rise in active users over the course of the past year. According to 2nd Watch, a managed cloud provider and AWS partner, the fastest growing AWS products used by their customers in 2017 include data crunching tool Amazon Elastic MapReduce (24% CAGR), network monitoring offering CloudWatch (23% CAGR) and serverless product AWS Lambda (18%) with Amazon Simple Storage, AWS Data Transfer and Amazon Virtual Private Cloud used by 100% of respondents. New products launched at re:Invent 2017 include Amazon SageMaker, a service aimed at helping developers build, train, and deploy machine learning models.

Amazon is strong in Cloud infrastructure: While Microsoft is the leader in the SaaS (Software as a Service) cloud market with a big margin, marked by its (1) huge enterprise installed base, (2) compatibility with its Office portfolio and (3) enhanced hybrid cloud solutions, AWS demonstrates excellent capabilities in PaaS (Platform as a Service) and IaaS (Infrastructure as a Service). According to Synergy Research Group, AWS' market share in Cloud infrastructure services (SaaS excluded) has hovered around 33% for the last 12 quarters while the overall market has almost tripled in size (vs Microsoft Azure:13%, IBM: 8%, Google Cloud Service:6%, AliCloud: 4%). Microsoft, Google and Alibaba are also bearing fruits on the growth of cloud spending. As more workloads get pushed to the cloud, all giants can benefit.

Figure. Amazon's supply chain



Source: Synergy Research Group, CASH

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6. Cost control

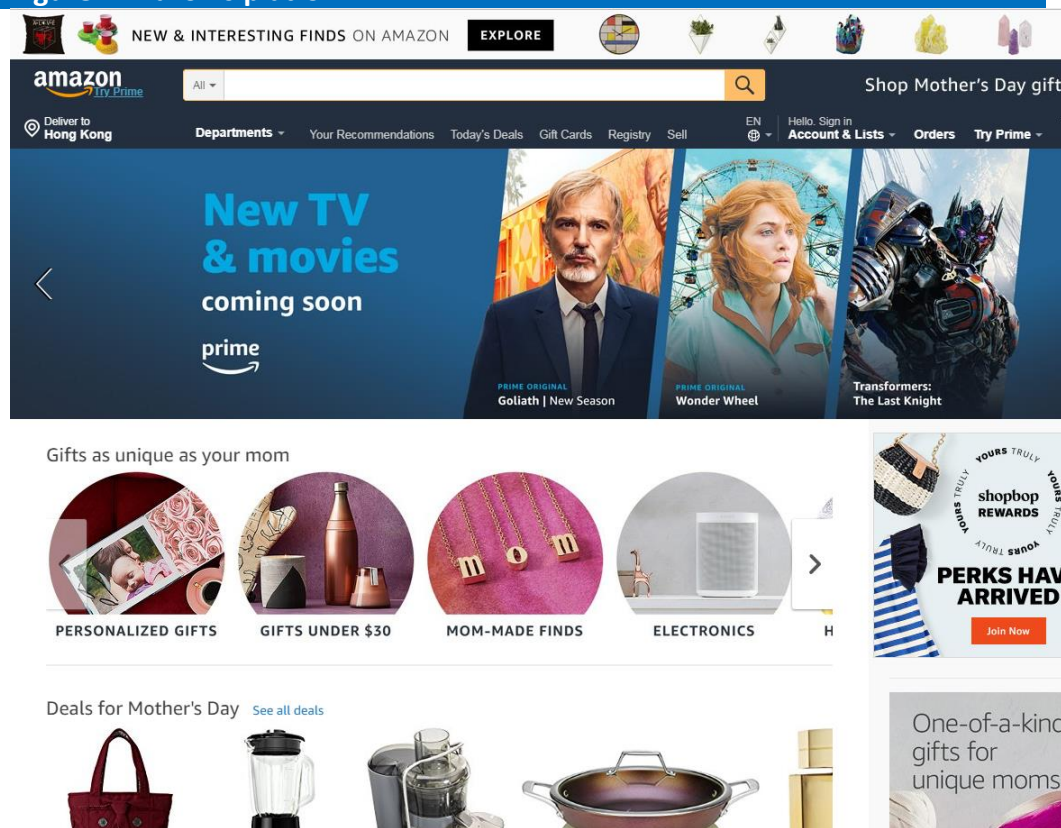
Cost control through automation: As mentioned before, the secret of Amazon's profitability is to provide customers with large purchase discounts and free delivery services in order to capture market share and customer loyalty. To support this, Amazon's approach is to make every effort to reduce costs in terms of financial management: reduce expenses, reduce staff number, use advanced and convenient order processing systems to reduce error rates, integrate delivery and save inventory costs.

Long term core competency –lower price, faster delivery, wider selections

1. Power of platform with superior buyer experience for user stickiness

Best product selection within a short time frame: Millions of third-party merchants are selling products in over a hundred different countries on Amazon platform. We think this helps customers **sort out their most favorite items with the lowest price and the highest rating** given by previous buyers’records. Prime membership model leverages the power of platform by providing customers with cheaper and faster delivery with ‘a package of ecosystem’ to improve user experience, enhancing user stickiness and bringing revenue stream.

Figure. Amazon’s platform



Source: Amazon, CASH

Low return rate of goods: Although Amazon embraces a wide variety of products, it keeps the return rate lower due to reasonable prices and high product quality and strong delivery services to meet customer needs. For example, to our understanding, Amazon's book withdrawal rate is less than 1%.

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2. Sound logistics network with economies of scale

(reduce threats from new entrants and stand away from rivalries)

Free delivery enhances consumption: Amazon provides Prime customers with free delivery service, and continues to **speed up the delivery service, reduce the price threshold for free delivery**. So far, Amazon has taken this promotion three times. The thresholds for the first two free delivery services were USD99 and USD49 respectively. In August 2002, Amazon reduced the threshold of free shipping by half, and started to implement free delivery service for customers whose total shopping price exceeds USD25 to promote sales growth. Free delivery has greatly stimulated people's incentive for consumption. We believe free delivery to customers can better achieve low price, high quality compared with brick and mortar store, so that Amazon's Prime members account for more than 100 million currently.

Delivery efficiency supported by automation: Amazon warehouses feature extensive use of barcode scanners and robots, carry out nearly non-stop order processing, item picking and shipping. Currently the system has evolved to a fully digital warehouse, distribution and fulfillment network which helps move goods between different places with high efficiency. Also, Amazon's fulfillment center only **maintains a small amount of inventory to keep cost lower**, whenever receiving customer orders, it will check the inventory of the fulfillment center. If the fulfillment center does not have enough stock, it must order from the supplier which may lengthen the time for delivery. To save the customer's waiting time and transportation efficiency, Amazon recommends customers not to put the goods that need to wait together with the goods that are in stock when ordering (combined packaging).



Source: rfgn.com, qstockinventory, CASH



Source: ARIRANG NEWS, CASH

Further cost reduction by outsourcing: Amazon currently delegates some of its domestic distribution business to U.S. Postal Service (USPS) and UPS and other professional logistics companies, we think this can help Amazon save logistics costs further. It is worth noting that Amazon uses its own truck or an independent carrier to deliver the ordered goods **from Amazon's warehouse to the warehouse of the local post office, and then the post office delivers the goods to customers.** In this way, the cost savings are equivalent to 5% to 17% of the ordinary price of the first-class mail, which is very impressive.

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Figure. the USPS and Amazon partnership



Source: mailmartlogistics, CASH

Wide options of shipping terms, flexible delivery methods, and accurate and reasonable fee standards reflect Amazon's strong logistics management:

Customers can receive the following information on Amazon website: shipment condition of auctioned goods, estimate of delivery time (customers can choose standard, 1-day and 2 day delivery), in-store picking, special handling (standard delivery based on land and sea, special one can be air transport), package recycling, shipping rates (based on different products and delivery period and method, and that can be priced on fixed amount, quantity, weights, etc), shipping restrictions, order tracking, etc.

3. Strong bargaining power towards buyers and sellers

By 360 pi, Amazon sells more than 340 million products from more than 185,000 unique sellers on the marketplace, not including books, media, wine and services with more than 310 million active customers in 2016.

Valuation

Our price target of USD1,950 is based on sum-of-the-parts analysis. We believe this methodology appropriately attributes value to the company's large, fast-growing, and profitable AWS segment. We apply a 1.7x EV/Sales multiple on 2019E Retail, justified as average global retailer peer. We apply a 21.8x EV/EBITDA multiple on 2019E AWS, which is the average of SaaS global software industry.

Figure. Valuation

Sum-of-the Parts Analysis

	Year	Sales	Adj EBITDA	EV/Sales	EV/EBITDA	Value
Retail	2019	276,065		2		470,062
AWS	2019		21,158		23	481,196
Total value						951,258
Less: Debt						24,743
Plus: Cash						34,126
						960,642
Total shares outstanding						484
Value per share						1,985

Source: CASH

Risk

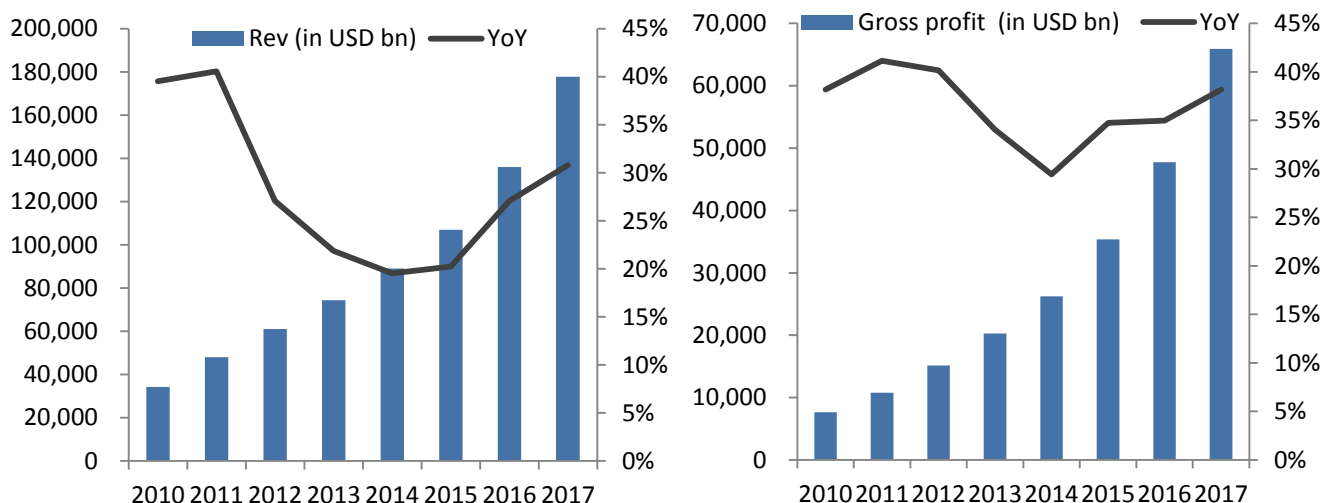
1. Headwind from US government

According to New York Times, President Trump abruptly issued an executive order demanding an evaluation of the Postal Service's finances in April 2018, asserting the power of his office weeks after accusing Amazon, the online retail giant, of not paying its fair share in postage in mid-April. We think these are the possible penalties US government may enforce: (1) Make all 3P sellers pay sales tax, or other tax schemes (none for now). Amazon pay sales tax on its own 1st party items currently. But this law change would actually hurt smaller sellers more. (2) Raise USPS shipping fees. We think this risk can be mitigated by moving some volumes to other shippers, or just accelerating their own fulfilment build out (what Amazon is now doing). We see limited long term impact on Amazon. 3) Amazon charges sellers fees for selling on Amazon and the US government can regulate this kind of seller commission structure. But if so, Amazon can divert more resources on 1st party items. With limited long term influence on Amazon's leadership in E-commerce, we think investors can buy on lower.

2. Fierce competition with retail peers

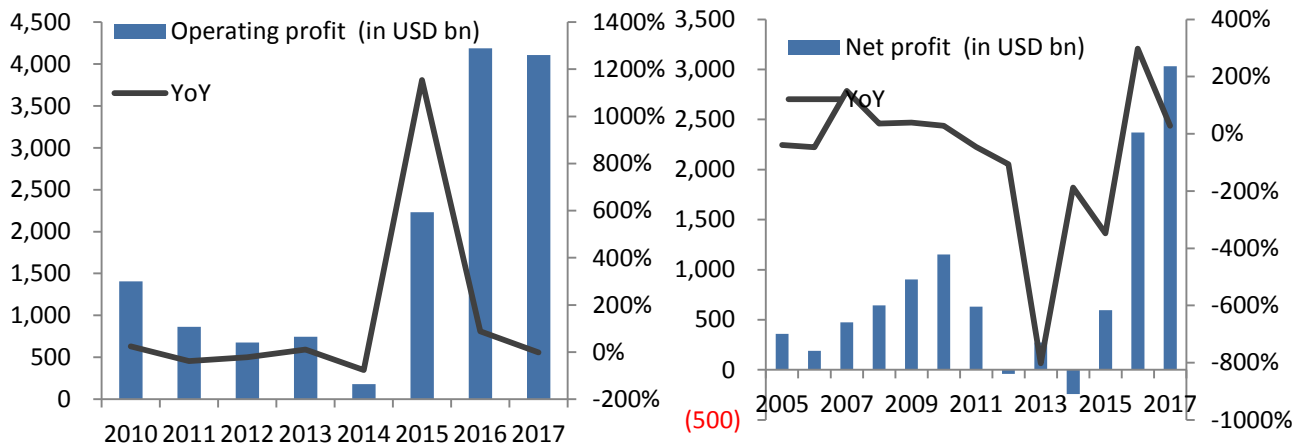
Domestically, Target, Macy's and Walmart also offered 'Black Friday in July' deals (discounts also for non-members). Ebay, one of Amazon's biggest rivals online also offers "thousands of exclusive deals" and is touting no membership required.

Figure. 2010-2017 Amazon's revenue and profit



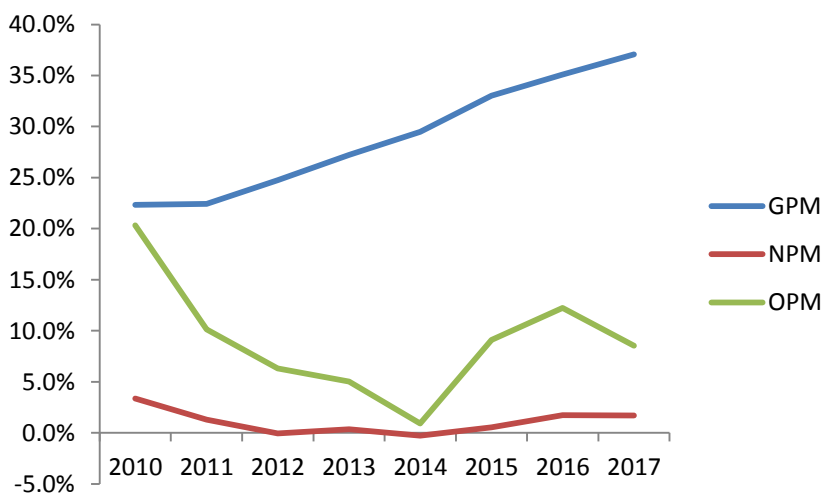
Source: Company data, CASH

Figure. 2010-2017 Amazon's operating profit and net profit



Source: Company data, CASH

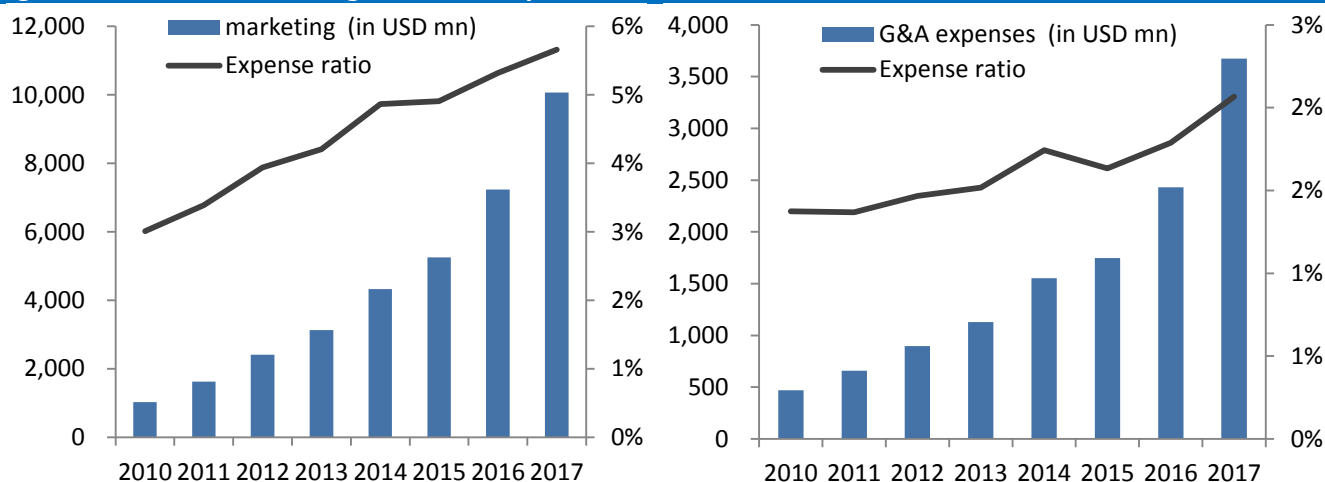
Figure. 2010-2017 Amazon's GPM, OPM and NPM



Source: Company data, CASH

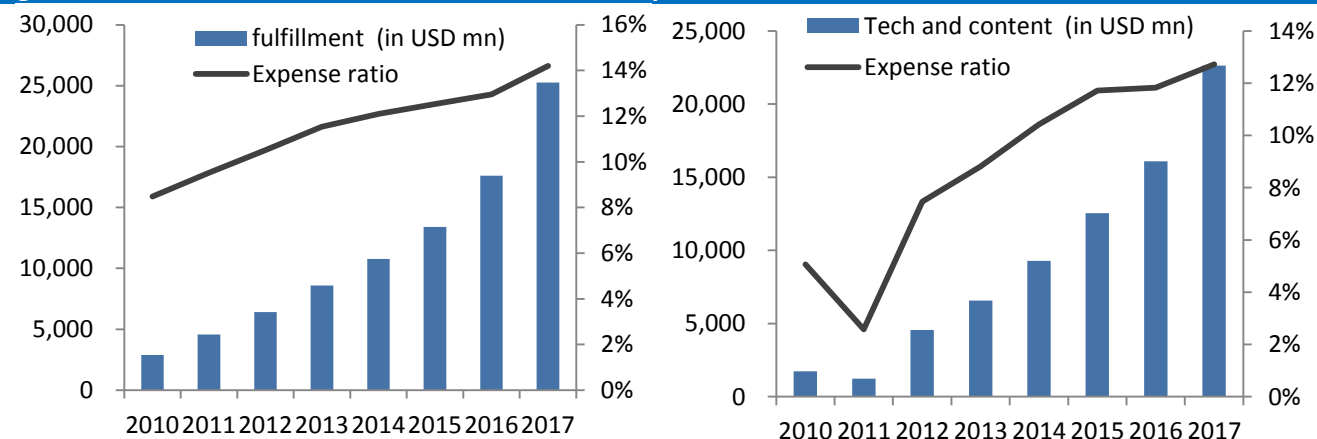
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Figure. Amazon's marketing and G&A expenses



Source: Company data, CASH

Figure. Amazon's fulfillment and Tech&content expenses



Source: Company data, CASH

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Amazon

Income Statement (USD million)				
Year-end 31 Dec	FY17	FY18E	FY19E	FY20E
Revenue	177,866	246,644	318,157	410,405
Cost of goods sold	-111,934	-149,787	-185,899	-230,360
Gross profit	65,932	96,857	132,258	180,045
SG&A	-36,577	-54,870	-75,458	-103,390
R&D	-22,620	-34,826	-48,233	-66,486
Other expense	-214	-214	-214	-214
Operating profit	4,106	5,409	7,263	9,718
EBITDA	15,584	20,728	27,022	35,207
Depreciation	-11,112	-14,804	-19,097	-24,634
Amortization	-366	-514	-663	-855
EBIT	4,106	5,409	7,263	9,718
Net interest expense	-646	-896	-1,156	-1,491
Associates & JCEs	-4	-4	-4	-4
Other income	346	346	346	346
Earnings before tax	3,802	4,856	6,449	8,569
Income tax	-769	-982	-1,304	-1,733
Net profit After tax	3,033	3,874	5,145	6,836
Minority interests	0	0	0	0
Other items	0	0	0	0
Preferred dividends	0	0	0	0
Normalised NPAT	3,033	3,874	5,145	6,836
Extraordinary items	0	0	0	0
Reported NPAT	3,033	3,874	5,145	6,836
Dividends	0	0	0	0
Transfer to reserves	3,033	3,874	5,145	6,836
EPS	6.27	8.00	10.63	14.12
DPS	0.00	0.00	0.00	0.00

Cashflow statement (USD million)

Year-end 31 Dec	FY17	FY18E	FY19E	FY20E
Net income	3,033	3,874	5,145	6,836
Depreciation	11,112	14,804	19,097	24,634
Amortization	366	514	663	855
Change in Net Working Capital	839	10,281	8,583	10,285
Cashflow from operations	18,434	29,472	33,487	42,610
Capital expenditures	-11,955	-15,366	-19,821	-25,569
Other non current assets	-11,223	0	0	0
Other non current liabilities	8,368	0	0	0
CF from investing acts	-27,819	-15,366	-19,821	-25,569
CF after investing acts	-9,385	14,106	13,666	17,042
Equity issue	4,704	-501	501	0
Debt issue	17,049	0	0	0
Convertible debt issue	0	-1	0	0
Dividends	0	0	0	0
CF from financial acts	9,860	-502	501	0
Net cashflow	475	13,604	14,167	17,042
Beginning cash	19,334	20,522	34,126	48,293
Adjustments	713	0	0	0
Ending cash	20,522	34,126	48,293	65,335
Ending net debt	4,221	-9,383	-23,550	-40,592

Source: Company data, CASH

AMZN.US, Buy, TargetPrice: 1950

Balance Sheet (USD million)				
Year-end 31 Dec	FY17	FY18E	FY19E	FY20E
Cash & equivalents	20,522	34,126	48,293	65,335
Marketable securities	10,464	10,464	10,464	10,464
Accounts receivable	13,164	16,543	21,339	27,526
Inventories	16,047	20,411	25,333	31,391
Other current assets	0	0	0	0
Total current assets	60,197	81,545	105,429	134,717
LT investments	0	0	0	0
Fixed assets	48,866	49,428	50,153	51,087
Goodwill	13,350	13,350	13,350	13,350
Other intangible assets	3,371	2,857	2,194	1,339
Other assets	5,526	5,526	5,526	5,526
Total assets	131,310	152,705	176,652	206,019
ST debt	0	0	0	0
Accounts payable	34,616	44,636	55,397	68,646
Other current liabilities	23,267	31,271	38,810	48,092
Total current liabilities	57,883	75,907	94,207	116,739
LT debt	24,743	24,743	24,743	24,743
Convertible debt	0	0	0	0
Other LT liabilities	20,975	20,975	20,975	20,975
Total liabilities	103,601	121,625	139,925	162,457
Minority interest	0	0	0	0
Preferred interest	0	0	0	0
Common stock	19,557	19,557	19,557	19,557
Retained earnings	8,636	12,510	17,654	24,490
Proposed dividend	0	0	0	0
Other equity and reserves	-484	-985	-484	-484
Total shareholders' equity	27,709	31,082	36,727	43,563
Total equity & liabilities	131,310	152,706	176,653	206,020

Key Ratios

	FY17	FY18E	FY19E	FY20E
Growth (%)				
EPS	26.1%	27.7%	32.8%	32.9%
Revenue	30.8%	38.7%	29.0%	29.0%
Profitability (%)				
Gross margin	37.1%	39.3%	41.6%	43.9%
EBITDA margin	8.8%	8.4%	8.5%	8.6%
EBIT margin	2.3%	2.2%	2.3%	2.4%
Net Margin	1.7%	1.6%	1.6%	1.7%
Effective tax rate	20.2%	20.2%	20.2%	20.2%
Dividend payout	0.0%	0.0%	0.0%	0.0%
ROE	10.9%	12.5%	14.0%	15.7%
ROA	2.3%	2.5%	2.9%	3.3%
Liquidity (x)				
Current ratio	1.04	1.07	1.12	1.15
Interest coverage	6.36	6.04	6.29	6.52
Leverage				
Net Debt/EBITDA (x)	0.27	net cash	net cash	net cash
Net Debt/Equity (%)	0.15	net cash	net cash	net cash
Activity (days)				
Days receivable	27.0	24.5	24.5	24.5
Days inventory	32.9	30.2	29.1	27.9
Days payable	71.0	66.1	63.6	61.1
Cash cycle	-11.1	-11.4	-10.0	-8.7

Source: Company data, CASH

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