Your Rivals' SEO on a Silver Platter semrush

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Should Amazon Continue to Stay in Your Portfolio?

Amazon missed its earnings big time, and competitors are starting to snap on its heels

September 25, 2017 | About: AMZN -4.39% ORCL -0.74%

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Amazon (NASDAQ:AMZN) has been on a steady decline since peaking at $1,083 per share on July 27 to $955 today. Could it be that this 12% decline represents both the current disappointment over the smallest earnings of 40 cents per share and expectation of weak earnings going forward?

To put the earnings into perspective, Amazon was earning $1.78 in the same quarter last year, and analysts expected $1.41 of earnings. The 71.6% drop in earnings is its second-largest in history and only the 72.3% earnings miss in second quarter of 2014 was larger.

Amazon continues to have a compelling story on disruption of high margins business in the grocery industry with its acquisition of Fresh Foods, original content expansion and its leading position in the cloud industry. The latest earnings plunge indicates that some fundamental shift is occurring in its dominant fields that even mega deals can't hide. Here are some weaknesses for your consideration.

- Warning! GuruFocus has detected 3 Warning Signs with AMZN. Click here to check it out.
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Lack of automation and security

While Amazon Web Services (AWS) had the first mover advantage when it launched in 2006 and have a strong ecosystem of products and services, it had a key weakness of not investing enough relative to its competitors in automating its cloud database services. Labor cost is a major factor for all IT services companies, and significant cost savings can drive even loyal customers to switch camps.

In **Oracle**'s (NYSE:ORCL) quarterly earnings call on Sept. 14, Chairman Larry Ellison noted that Oracle had created autonomous databases much cheaper than running Amazon's Redshift database on the cloud. In fact, co-CEO Mark Hurd noted that Oracle's database is 10 times faster than Amazon's database with less downtime. AWS accounts for $4.1 billion out of $37.96 billion of total revenue.

Oracle is confident that it can provide better technical solutions for clients who jump over from Amazon. In fact, cybersecurity is fast becoming an important aspect and new research by RedLock Cloud Security Intelligence shows that 55% of organizations fail compliance checks. One important reason is that skilled cybersecurity personnel are not readily available globally, according to research by IT Solution System. When an organization suffers a crippling attack on its cloud system, it would also be more willing to switch vendors. This would curtail Amazon's leading cloud position.

GuruFocus has detected 3 Warning Signs with Amazon.com Inc AMZN.
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kosalmmuse	han
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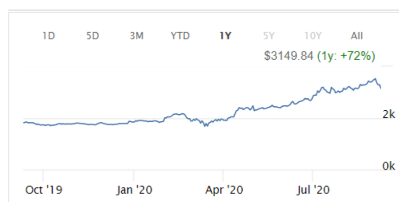
AMZN Price Chart →



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Weak retail earnings

We are living in a period of rising consumer confidence as steady job gains and strong economic growth continue. Discretionary spending is rising, and U.S. consumers are 4% nationwide, and e-commerce is expected to grow by 14% which is right in Amazon's strength.

In the latest quarter, its earnings dropped by 38% from $702 million to $436 million. We all know that Amazon focuses more on the top line than the earnings, and its top line did grow from $17.7 billion to $22.4 billion. How long can it take shrinking margins before it loses the ability to provide innovative products and services to clients? Such services would require resources that shrinking profitability would not allow.

Not worth the risk

Even at the price of $955 per share, Amazon is trading at 196 times earnings which is absurd. Why should investors take such high earnings multiple when Amazon is not returning any dividends? The Fed is tightening its monetary policy and as cheap money goes away, investors will be more focused on the cash flow than ever before.

As Amazon muscles into other areas such as pharmaceuticals which is not its core strength, it will have higher execution risk. Its expansion into Singapore with Prime Now came with its hiccups and local competitors would respond to dull its edge. This will only be seen in the quarters ahead but investors are not waiting for the results. Should you?

Disclosure: No Amazon shares.

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