# <u>Amazon (AMZN)</u>

## <u>October 2nd, 2025</u>

### <u>Company 101: what does it do? how does it make money?</u>

Amazon (AMZN), is the largest e-commerce company in the world and one of the most influential players in technology, cloud computing, and digital advertising. It began as an online bookstore in the 1990s, but over the past three decades it has expanded into virtually every category of retail, becoming the default shopping platform for hundreds of millions of consumers globally, with an especially strong foothold in North America. Amazon has achieved a level of dominance in online retail that creates a constant flow of buyers and sellers into its ecosystem, reinforcing its role as a market place and a retailer and strengthening its competitive position in the market.

The company has been successfully diversifying itself into a conglomerate of various businesses, with the retail one being its main source of revenue and the other ones having higher margins and complementing the retail operations. AWS, or Amazon Web Services, is Amazon's cloud computing arm and serves as the world leader in data storage. Meanwhile, its subscription service, Amazon Prime, supplements the main retail business with faster delivery times and discounts as well as boasts one of the world's biggest streaming services, on par with competitors like Netflix or Disney+. Finally, Amazon's dominance in the retail market allows them to charge large amounts of money in advertisement and product placement, which has become one of their most stable sources of income.

Amazon's retail operations remain the foundation of its business, though they are the one with the lowest margin. The first-party (1P) retail business functions like a traditional merchant model, where Amazon purchases inventory from manufacturers or wholesalers and sells directly to consumers on its website. These sales are recognized at gross merchandise value, inflating the top line, but margins are structurally thin, often in the low single digits, as Amazon bears the cost of inventory, procurement, logistics, and delivery. The strategic purpose of 1P retail is less about profitability and more about driving customer traffic, building trust in the platform, and increasing the value of Prime by facilitating access to a vast variety of goods.

The third-party (3P) marketplace has become the true growth and margin engine of Amazon's retail arm. This is the division where Independent sellers list their products on Amazon's platform, while Amazon collects revenue in the form of fees. In this division, Amazon only books its "take rate" as revenue, meaning that what is recognized as revenue is only the fees generated directly to Amazon. This structure is meaningfully higher margin since Amazon avoids inventory costs, and just collects recurring fees by allowing sellers to use its vast network of software, logistics and delivery.

Amazon has also extended its retail presence into physical stores, most prominently through Whole Foods Market and Amazon Fresh. Grocery plays a strategic role by embedding Amazon deeper into consumers' everyday routines while enhancing the stickiness of Prime.

In total, the retail division has generated over $100B in revenue for Amazon in Q2 alone.

Amazon Web Services (AWS) is the company's profit powerhouse and the segment that has arguably done the most to transform Amazon into a diversified technology giant. AWS offers multiple services to its corporate partners, including storage, databases, and machine learning, with its business model being built around usage-based pricing where customers pay either on a pay-as-you-go basis or through committed contracts for long-term workloads. Customers who adopt AWS typically embed it into their workflows, which creates significant switching costs and lock-in. The broad ecosystem of partners, developers, and applications only strengthens its competitive advantage. This creates recurring, high-quality revenue streams that are deeply integrated into a customer's IT operations, giving AWS a durable economic moat.

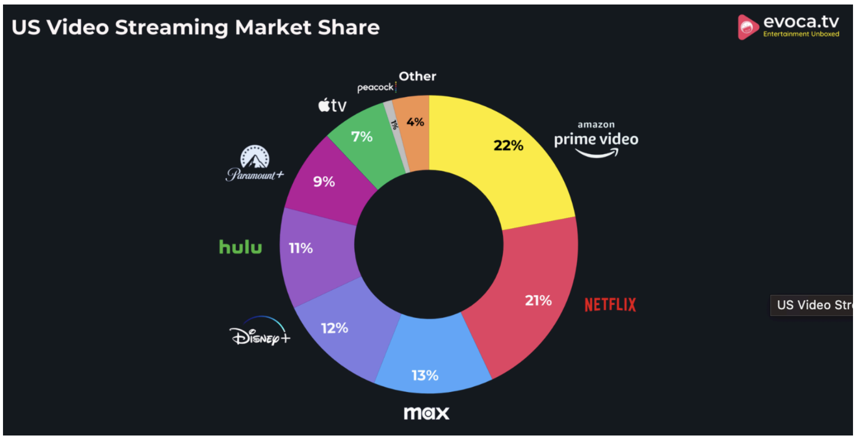
AWS's scale and breadth of services distinguish it from competitors. It pioneered the modern cloud industry and continues to hold a leading market share against Microsoft Azure, Google Cloud, and Oracle. By most estimates, AWS holds around 31% of the market, while Google Cloud and Azure hold 13% and 20% respectively.

AWS contributed to around $30.9 billion in revenue in Q2 2025 and it represented more than half of the company's operating income. With high operating margins and constant operations given its stronghold in customers' IT networks, AWS provides the cash flow necessary to fund Amazon's retail, even subsidizing losses if necessary, Prime investments, and emerging bets like mass automation of fulfillment stations. AWS is the segment that allows Amazon to take risks elsewhere while remaining consistently profitable.

| | 2023 | 2024 |
|---|---|---|
| Operating Income (Loss) | | |
| North America | $ 14,877 | $ 24,967 |
| International | (2,656) | 3,792 |
| AWS | 24,631 | 39,834 |
| Consolidated | $ 36,852 | $ 68,593 |

Amazon's subscription business is anchored by Prime, the membership program that has become central to customer loyalty. Prime bundles free shipping with streaming video and music, exclusive shopping deals, grocery benefits, and reading perks through Kindle. The program not only generates recurring revenue but also increases customer frequency and retention, making it one of Amazon's most powerful tools for building long-term relationships with consumers.

Prime Video plays an important strategic role within this ecosystem. Though it competes directly with Netflix, Disney+, and Apple TV+, Amazon was early in the game, one of the first streaming services to gain popularity after Netflix and managed to grab a respectable market share in the competitive industry. While high investments in movie and show productions don't allow for high margins in the segment, Prime Video is still a key of Amazon's business by hooking customers in from the entertainment side and then guiding them to the retail opportunities. The ownership of franchises such as James Bond (which came with the acquisition of MGM) and the establishment of stable shows like The Boys engages subscribers and encourages them to continue in the Amazon ecosystem.




Last quarter Subscription services revenue, which includes came in at $12.2 billion, up 12%. This does not include, of course, all the products that were bought with prime discounts and prime same-day shipping.

Amazon's advertising business has quickly grown into the third-largest digital ad platform in the world, behind only Google and Meta (Facebook), and is now one of the company's most important growth drivers and Amazon, through its retail division, has one of the top competitive advantages an advertiser could want: buyer intent.

The goal of advertisement is to sell a product and good advertising platforms, offer great ways for companies to reach consumers potentially interested in the product. Turns out, when a consumer searches on amazon for a product, say tennis ball, he or she has a very high intention of buying a tennis ball, much higher than if they type tennis ball on Google or see a tennis video on Instagram. This means that a tennis ball company will pay a lot of money and engage in an advertisement bidding war with other companies to be the top listing on Amazon for that product. As a result, Amazon's ad auctions are highly competitive, pushing up pricing and fueling revenue growth. This also creates an environment where businesses that wouldn't normally advertise now have to start doing so just to stay competitive on the website listings, pushing revenues and margins higher from new businesses.

On its most recent earnings call, it was announced that Amazon ads generated $15.7 billion in revenue in Q2 2025 and grew 22% YoY, making it the company's fastest growing segment.

**<u>Why it has an economic moat</u>**

Amazon has become the central marketplace of the internet, the place where consumers instinctively begin their shopping journey and where businesses cannot afford not to be. The cost of opportunity for a seller that skips Amazon is enormous, it means not having access to the world's largest pool of digital customers. It's like a website not being listed on Google or not optimizing for Google SEO.

This reality has created a powerful feedback loop where, because consumers know they can find everything on Amazon, sellers are compelled to list their products there; and because sellers list their products there, consumers know they'll find what they need. Over time this has made Amazon not just an online store, but *the* online store.

Within this model, Amazon's own first-party retail business gives it the ability to directly manage key categories and fill product gaps, ensuring that customers never leave empty-handed if there is demand there not attended by other merchants. Meanwhile, its third-party marketplace drives higher-margin revenue and leverages the platform effect at scale, letting Amazon earn a cut from the vast majority of sales happening on its site and increasing its profit margin now that they don't have to deal with inventory. Together, these two pieces have built a marketplace with unrivaled breadth, convenience, and retention.

AWS has grown into the go-to provider of cloud services, supporting everyone from startups to governments, becoming the backbone of these institutions' data management. AWS's backlog of $195 billion (as of Q2), represents years of committed spending that will create a predictable revenue stream for the company and further builds the argument that companies are increasingly reliant on Amazon. While growth has cooled to only 17% YoY, its dominance is underpinned by one simple fact: once a business builds its IT systems on AWS, moving away is prohibitively expensive, time-consuming, and risky. The switching costs are so high that AWS has effectively locked in a massive global customer base, ensuring that it remains an important cloud provider even as competition intensifies.

Prime, however, is crucial in binding Amazon's ecosystem together. Prime Video's vast library of shows, movies, and live sports has created a content portfolio strong enough to attract people who might not even think of Amazon as a retailer. Once inside the Prime ecosystem through Video, however, those same subscribers shop more often and spend significantly more than non-members. Prime's genius is that it captures both shoppers and viewers, keeping them engaged across entertainment and commerce, and making it harder and harder for them to leave.

Finally, advertising one of Amazon's most profitable and rapidly expanding businesses. Unlike ads on Google or Meta, which capture fleeting attention, Amazon's ads capture purchase intent. As explained before in this report, when someone types a product into Amazon's search bar, they are, more often than not, already thinking of buying. This leads to some of the highest conversion rates in digital advertising, and the result is a bidding war among sellers for visibility. Businesses often end up spending more than they intended simply to remain relevant and not to go to page 2, and Amazon captures that incremental spend as high-margin profit.

In order to improve its FCF and balance sheet management, Amazon created an early payment initiative with C2FO, a marketplace in which suppliers whose invoices have already been approved have the choice to get paid before the usual payment terms in exchange for a small discount to Amazon. Suppliers do not have to wait 60-90 days to receive payment because they can now access their cash right away. Amazon decides whether to accelerate a payment or leave it on a regular payment schedule. Amazon enjoys holding its formal payables out for days and keeping cash from customer purchases for months prior to making the cash payment, thereby enhancing free cash flow and providing management flexibility on the timing and use of cash. Similarly, suppliers in need of liquidity can choose to get paid before their normal terms in exchange for a small fee. Not relying on expensive short term borrowings without sacrificing too much margin is a win-win. In this case, Amazon is able to maintain or even enhance their own unit economics by taking the invoice discount and improve the overall health of the supply base through providing working capital to critical partners. This keeps vendors stable and Amazon in control of its cash cycle, choosing to either improve their margins (by paying early) or hold onto cash longer (to further generate capital or in case it needs money now).

Finally, but key to Amazon's consumer loyalty in retail, its logistics infrastructure is among the company's strongest barriers to competition, changing what was historically the largest cost center in retail into a structural asset that few can replicate. Over the last few decades, Amazon has developed a dense network of fulfillment centers, sortation centers, last-mile vans and its own air fleet, which has allowed it to push delivery speed such that same-day and next-day shipping is the expectation for Prime customers. This network's scale produces lower, per-unit logistics costs, establishing a positive feedback loop since more customers lead to more sellers which lead to more volume which leads to lower costs and faster speed. By bringing logistics largely in-house, moving away from FedEx or UPS recently, Amazon is able to maintain its own standards and reliability while also generating revenue through its Fulfillment by Amazon program that penetrates sellers ability more deeply into the ecommerce platform. Therefore, Amazon sets its delivery expectations to levels that competitors are challenged to maintain, turning its logistics network into not just an operative advantage but a primary competitive barrier that reinforces its entire flywheel of retail.

All of these different divisions, combined with an extremely favorable cash flow environment and one of the most robust logistics infrastructure in the world, make Amazon enjoy an incredibly strong economic moat and competitive advantage where each segment strengthens the others, creating a self-reinforcing flywheel. This makes Amazon an ecosystem with competitive advantages that span across industries, with its retail platform as the cornerstone of revenue and AWS as a powerful vertical in B2B tech.

**Risks and reasons for market negativity:**

The biggest drag on Amazon's stock following Q2 2025 came from AWS, which despite reporting strong revenue growth of 17%, showed margin performance that left most analysts disappointed and was the main cause for the stock's -8% collapse after otherwise great earnings. Depreciation from the rapid build-out of new data centers and heavy investments into AI infrastructure all combined to put pressure on operating margins that declined from a record high of 39.5% in Q1 to 32.9% in Q2. While AWS is still the largest player by revenue and has the broadest service set, Microsoft Azure and Google Cloud have been taking a larger share of the fastest-growing AI training workloads, growing at 39% and 32% compared to AWS's 17%, and that has introduced a real debate about whether AWS can maintain its leadership position over the long run.

The key point, however, is that AWS's backlog remains enormous, with nearly $195 billion in committed revenue, which underscores that demand is still present and growing, at 25% YoY to be more precise. This makes the current margin weakness look much more like a temporary issue rather than a structural decline in the business model. That said, I will still treat AWS with more caution in my valuation framework by assuming lower long-term margins and applying a lower multiple for the whole company too. The moat is still there, but the economics going forward are unlikely to match the level of dominance AWS enjoyed during its first decade of hypergrowth.

The second issue flagged by analysts was capacity constraints, as Amazon's management openly acknowledged that shortages in power supply and available data center space were acting as a bottleneck on AWS's ability to capture the surge in AI demand. Investors naturally worry that this opens the door for Microsoft or Google to win share simply by having infrastructure ready to deploy faster, and in a market as competitive as cloud, missing even a portion of incremental demand can be costly.

That said, this is not an issue unique to Amazon. Every hyperscaler is competing for the same limited grid power, the same land for data centers, and the same specialized hardware required to run large-scale AI workloads. The fact that Amazon's management team realized this and made this public, whereas Google and Microsoft didn't, shouldn't be treated as a weakness, but as a testament to their transparency (not saying that Google or Microsoft are hiding anything, but I can't see this bottleneck being a company specific problem). Even so, I will account for this reality in my valuation by assuming that AWS will recognize some revenue later than it otherwise would have, especially when combined with the margin pressure already discussed.

Finally, Amazon's forward guidance was softer than the market wanted to see, and despite delivering a strong Q2 headline number, management guided cautiously for Q3, particularly with respect to operating income. The company signaled that margin expansion in North America would be slower than expected, international operations would remain in the red, and cost pressures from tariffs, labor, and continued investment in content would weigh on results.

Here again, though, context is important. Amazon has a long history of guiding conservatively and then beating those same expectations, with EPS surpassing estimates in all quarters since Q3 2023, a consistent pattern of upside surprises against both Street estimates and internal guidance. This does not mean the current guidance should be ignored, but it does suggest that management is beign cautious in setting expectations, leaving room for operational outperformance, especilaly considering that Amazon has incredible opportunities for growth in the retail division (especially in the international blue ocean) and in the advertisement space, where they grew at +20% this year.. I will continue to treat the guidance carefully by assuming more modest growth in the near term, but I will also avoid cutting estimates too aggressively given Amazon's consistent tendency to outperform its own outlook.

**Valuation 101:**

Revenue:

Amazon's retail business is, by far, its largest in revenue, bringing over $100 billion to the company in Q2 alone. Considering the incredible network effects of Amazon's retail platform, where customers go to Amazon because they know sellers will be there and vendors think the same, combined with its ability to generate growth by empowering third party vendors through its 3P system, where Amazon has do to minimal work for its marginal revenue, I believe Amazon's retail division will grow faster than the sector's projected 8-10% growth.

Considering, even, its ability to leverage Amazon's deep pockets to subsidize deliveries and products when entering new international markets, I believe Amazon's retail division will grow at around 13% per year for the next 5 years. This represented around 60% of revenue.

AWS is the main concern of analysts, who saw the division grow at only 17% YoY. According to Goldman Sachs, the cloud market should grow at around 22% per year until 2030. This was a report published more than a year ago and much of the cloud world has changed since then, but I still think this is a solid baseline, considering Amazon's growth of 17% and their competitor's growth of around 30%. Given concerns about cloud growth coming from analysts and management, but at the same time considering the strong backlog and established market dominance that Amazon has secured, I will consider a 21% growth YoY for the division. This represented around 20% of revenue.

Amazon' subscription services, aka Prime, is also a very strong revenue generator. As mentioned before, Amazon has managed to carve out an impressive market share of the television streaming sector, battling entertainment giant Netflix and even winning against Disney, and has curated a great catalog of original content and purchased IP. This strong streaming brand combined with a passion for consumers to have perks in the retail division, such as same day delivery and discounts, will cause this division to grow a little faster than the TV streaming market. Given that most predictions assume that the global streaming market will grow at around 16-20% a year, I will assume a growth of 19%, on the higher range of these estimates, given the competitive advantages outlined. This also represents around 10% of revenue.

In terms of Amazon's advertising division, PwC forecasts that the online advertising market will grow at a compound annual rate (CAGR) of 8.52% from 2024 through 2029. Given that vendors are starting to realize the power of advertising on Amazon and considering Amazon's competitive advantage in putting interested consumers with high propensity to buy in contact with a vendor, I expect this growth to be higher, at around 15%. This represented around 10% of Amazon's revenue in Q2.

Calculating a weighted average for revenue growth, I expect Amazon to grow at around 15% per year over the next 5 years.

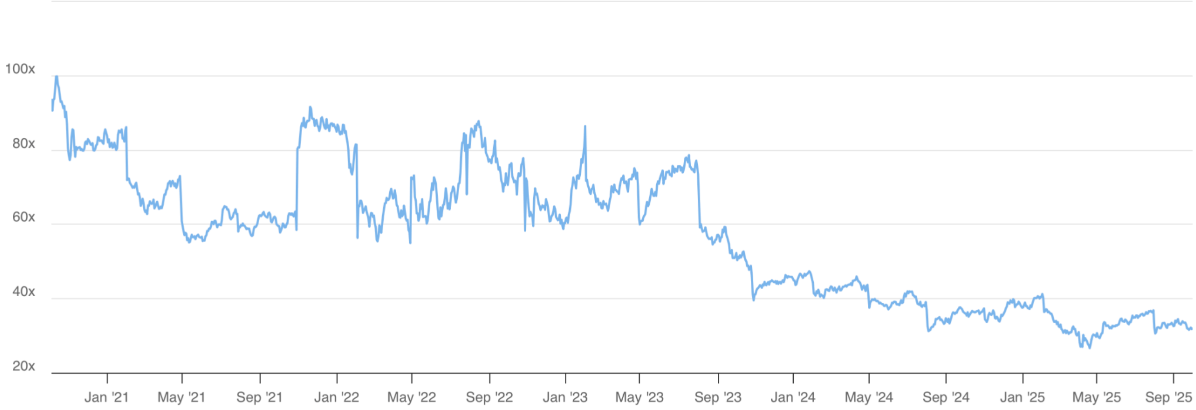
Net Income Margins

Given that the divisions with faster growth are also the divisions with greater margins, and even inside the retail division, the higher margin 3P retail is expected to grow faster, I also expect Amazon's margin to grow over the next half-decade, growing at around 0.5% per year in that period. Considering Amazon's reported net income margin of 10.8% in Q2 but overall 9.3% in 2024, at risk of being conservative I will assume a 10% margin for 2025 and we will go from there.

P/E multiple

Amazon, for the past 5 or so years, has been increasingly declining their P/E multiple as the company matures and most of the growth precified in the P/E turned into financial reality.

The company that once traded at around 100x future earnings now trades at arond 35.




The company has been trading at around 40x earnings for more than a year now and I think it makes sense given its competitors like Google and Microsoft as well as its growth projections for the next few years and its massive competitive advantage/economic moat. Again, at the risk of being conservative I will employ a 35x multiple on Amazon, which I think is fair to express its market positioning and opportunities going forward.

Considering all of the above, we arrive at this projection:

| | Revenue (M) | Revenue Growth | NI Margin | | |
|---|---|---|---|---|---|
| Y0 | $670.038,00 | 15% | 10,0% | Company | AMZN |
| Y1 | $770.543,70 | 15% | 10,5% | Margin Change | 0,5% |
| y2 | $886.125,26 | 15% | 11,0% | | |
| y3 | $1.019.044,04 | 15% | 11,5% | | |
| y4 | $1.171.900,65 | 15% | 12,0% | market cap (M) | 2.371.982,67 |
| y5 | $1.347.685,75 | 15% | 12,5% | Future price (M) | 5.896.125,14 |
| | | | | Multiple | 35 |
| Y5 FCF | $168.460,72 | | | | |
| | | | | return (CAGR) | 19,98% |

A 19.9% CAGR for a company like Amazon in the next 5 years seems extremely generous, especially considering that this model isn't considering any dividends that the company may pay out in the future. I will be buying this stock and holding it as one of the biggest convictions in my portfolio due to the quality of the company and future opportunities for the business.