Amazon.com's (AMZN) Q3 2020 Results - Earnings Call Transcript

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Q3: 2020-10-29 Earnings Summary

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EPS of $12.37 beats by $4.84 | Revenue of $96.15B (37.39% Y/Y) beats by $3.53B

Amazon.com, Inc. (NASDAQ:AMZN) Q3 2020 Earnings Conference Call October 29, 2020 5:30 PM ET

Company Participants

Dave Fildes - Head, Investor Relations

Brian Olsavsky - Senior Vice President and Chief Financial Officer

Conference Call Participants

Brian Nowak - Morgan Stanley

Doug Anmuth - JPMorgan

Justin Post - Merrill Lynch

Heath Terry - Goldman Sachs

Mark Mahaney - RBC

Eric Sheridan - UBS

Operator

Thank you for standing by. Good day, everyone and welcome to the Amazon.com Q3 2020 Financial Results Teleconference. At this time, all participants are in a listen-only mode. After the presentation, we will conduct a question-and-answer session. Today's call is being recorded.

For opening remarks, I will be turning the call over to Head of Investor Relations, Dave Fildes. Please go ahead.

Dave Fildes

Hello and welcome to our Q3 2020 financial results conference call. Joining us today to answer your questions is Brian Olsavsky, our CFO. As you listen to today's conference call, we encourage you to have our press release in front of you, which includes our financial results as well as metrics and commentary on the quarter. Please note, unless otherwise stated, all comparisons in this call will be against our results for the comparable period of 2019.

Our comments and responses to your questions reflect management's views as of today, October 29, 2020, only and will include forward-looking statements. Actual results may differ materially. Additional information about factors that could potentially impact our financial results is included in today's press release and our filings with the SEC, including our most recent annual report on Form 10-K and subsequent filings.

During this call, we may discuss certain non-GAAP financial measures. In our press release, slides accompanying this webcast and our filings with the SEC, each of which is posted on our IR website, you will find additional disclosures regarding these non-GAAP measures, including reconciliations of these measures with comparable GAAP measures. Our guidance incorporates the order trends that we've seen to date and what we believe today to be appropriate assumptions.

Our results are inherently unpredictable and may be materially affected by many factors, including fluctuations in foreign exchange rates, changes in global economic conditions and customer spending, world events, the rate of growth of the Internet, online commerce and cloud services and the various factors detailed in our filings with the SEC.

This guidance also reflects our estimates to date regarding the impact of the COVID-19 pandemic on our operations, including those discussed in our filings with the SEC and is highly dependent on numerous factors that we may not be able to predict or control, including: the duration and scope of the pandemic, including any recurrence; actions taken by governments, businesses and individuals in response to the pandemic; the impact of the pandemic on global and regional economies and economic activity, workforce staffing and productivity and our significant and continuing spending on employee safety measures; our ability to continue operations in affected areas; and consumer demand and spending patterns as well as the effects on suppliers, creditors and third-party sellers, all of which are uncertain.

Our guidance also assumes, among other things, that we don't conclude any additional business acquisitions, investments, restructurings or legal settlements. It's not possible to accurately predict demand for our goods and services and therefore, our actual results could differ materially from our guidance.

And now I'll turn the call over to Brian.

Brian Olsavsky

Thank you for joining us today. I'd like to start by extending a big thank you to all the folks who worked hard to make this year's Prime Day a great success, not only for our more than 150 million Prime members around the world. But also for the hundreds of thousands of small and medium-sized businesses who sell on our Amazon store many of whom are facing their own challenges during this pandemic. These businesses thrived on Prime Day. With third-party sellers recognizing more than $3.5 billion in sales over the two-day global event, that's 60% increase compared to Prime Day last year.

I also want to thank and recognize the contributions of more than one million Amazon employees and delivery partners who are continuing to work hard to serve our customers all around the world, who will continue to spend what it takes to ensure the safety and well-being of our employees and partners.

Now let me share some highlights from the quarter. Our Q3 results largely reflect a continuation of demand trends we saw when we exited the second quarter. The strong demand in sales growth across our major product categories globally including hardlines, consumables, softlines and media. We also continue to see strong Prime member engagement. Prime members continue to shop with greater frequency and across more categories than before the pandemic began. They continue to expand their usage of Prime's digital benefits including Prime video.

Internationally, the number of Prime members who stream Prime video grew by more than 80% year-over-year in the third quarter and international customers more than doubled the hours of content they watched on Prime video compared to last year. We're also reaching more customers with our grocery offerings. In Q3, our year-over-year growth rate of online grocery sales continued to accelerate and we continue to offer more convenient options for customers including grocery pick up which is now available from all Whole Foods Market stores. And just as we saw in Q2, Prime member renewal rates improved in Q3 year-over-year.

3P sellers who as I mentioned are largely comprised of small and medium sized business continue to be important part of our offering to customers. Our 3P sellers services revenue continue to grow faster than online stores revenue. With particularly strong growth this quarter in FBA, as we return to similar mix of FBA as a percentage of total 3P units as we've seen prior to COVID. 3P units continue to represent over half of overall unit volume increasing to 54% of the total unit mix in Q3.

We're investing heavily to support sellers and are pleased to report that over half a million sellers are seeing record sales in our stores this year. We continue to focus on stepped up employees safety particularly in our fulfillment and logistics operations. To help ensure the safety and well-being of our employees and partners as well as the employees and customers shopping at our Whole Foods Market and other stores.

This of course has added incremental cost to our P&L. The largest portion of these costs relate to continue productivity headwinds in our facilities including process revisions to allow for social distancing and incremental cost to ramp up new facilities and the large influx of new employees hired to support strong customer demand. This also includes investments in PPE for employees and enhanced cleaning of our facilities.

In total, we've incurred more than $7.5 billion in incremental COVID related costs in the first three quarters of 2020 and we expect to incur approximately $4 billion in Q4. Our consolidated revenue and operating income exceeded the top end of our guidance range. As demand remains strong in the quarter the extra volume and operating leverage helped us to achieve higher than expected profitability. And we saw another strong quarter of revenue growth in operating income performance in AWS and advertising. We had good leverage with our fulfillment centers as well as in Amazon logistics, our transportation network despite the higher COVID related cost that I mentioned. Although we had strong growth in our network in Q3 some of our fulfillment network expansion shifted out a few weeks thought it happened in Q4 rather than Q3.

Once new buildings open, their short-term headwind to profitability as they ramp up and we prepare for Q4 peak. More of this headwind will be felt in Q4 rather than in Q3 and this is reflected in our Q4 guidance.

We were able to meet the heightened demand in Q3 because we opened up more network capacity particularly in our transportation network. I pointed two important drivers of this. First, we hired a lot more people to support the strong customer demand. We welcomed 250,000 permanent full time and part time employees just in Q3 and have already added about 100,000 more in the first month of Q4. I will note that these are permanent jobs with industry leading pay including Amazon's $15 minimum wage and great benefits such as health insurance, 401(k) plan and parental leave.

Secondly, this has been a big year for capital investments. We've invested nearly $30 billion in CapEx and finance leases through the first nine months of 2020 including over $12 billion in Q3. As I mentioned last quarter, we expect to grow our fulfillment and logistics network square footage by approximately 50% this year which includes significant additions to our fulfillment centers as well as our transportation facilities. Majority of these buildings open in late Q3 and into Q4. About half of this square footage growth will be on the transportation side to be opening more sort centers and delivery stations.

And finally, in AWS customer usage remained strong. We continue to see companies meaningfully growing their plans to move to AWS. While we're busy gearing up for our Annual re:Invent Conference. This year reinvent will be a free three-week virtual conference running from November 30th through December 18th. We're extremely grateful to our employees across Amazon who have delivered on unprecedented demand for several months now as well as a strong Prime Day in October.

We're ready to go and looking forward to meeting the needs of our customers this holiday season. With that, let's move onto Q&A.

Question-and-Answer Session

Operator

[Operator Instructions] our first question comes from Brian Nowak with Morgan Stanley. Please proceed with your question.

Brian Nowak

Thanks for taking my question. I've two Brian. The first one you mentioned the fulfillment center saw good leverage in the quarter. Can you just talk to us about some of the qualitative drivers of this improvement you're seeing in fulfillment cost per fulfilled unit in the quarter and sort of year-to-date and how to think about the durability of that overtime? And then secondly, I think throughout the summer Amazon logistics launched the third-party delivery service in the UK. I'm curious just to hear about early learnings from that product and how you think about scaling that to other countries and maybe globally? Thanks.

Brian Olsavsky

Sure, Brian. Thanks for your question. Yes, the fulfillment center cost is going to be a blend of part of the COVID related cost that I mentioned in and itemized. Offset by some really strong leverage, I would say that we've been running very consistently high levels really since all of our employees came back in the first or second week of May and some of them been on unpaid leave. So that demand is very consistent and strong and has created a lot of favorable leverage because again the order pattern being high and consistent as leveraging our fixed cost assets. Things like our delivery routes are more dense at high volumes. So we see even transportation some increased efficiencies. Offsetting that again is productivity elements that we've articulated things like social distancing, extended breaks. Other steps we're taking to keep people safe and distanced in our facilities, in our delivery network.

Dave Fildes

And this is Dave, I don't have much to share I think on, what we've got going on with any of [indiscernible] efforts other than I'll just say, we're always working to develop new and innovative ways to support. The companies we work with including small and medium-sized businesses we sell on Amazon and that includes testing and shipping programs that can help any of these businesses gets packages to customers quickly and reliably.

Brian Nowak

Great, thank you both.

Operator

Our next question comes from Doug Anmuth with JPMorgan. Please proceed with your question.

Doug Anmuth

Thanks for taking the questions. Brian just wanted to go back to the 4Q operating income guide. I appreciate your thoughts there. Just trying a dig a little bit deeper in terms of how you're thinking about it kind of beyond the $4 billion in COVID cost. It still feels like maybe there's some more in there that we're not thinking about perhaps beyond the square footage increases and the incremental headcount. So if you've any comments there? And just curious I know it's early on 2021, but you've obviously done a ton of investment this year and with the 50% square footage increase and you tend to cycle at times in terms of CapEx investment. Just how you think about [adjusting] [ph] that kind of build out as you go forward? Thanks.

Brian Olsavsky

Sure, Doug. One last comment, I forgot to mention to Brian on his last question is, the fact that a lot of that heightened demand so far coming to Q2 and Q3 when we tend to have excess capacity before Q4, so that's another source of leverage especially in non-peak orders. As far as guidance is concerned again, I think there's lot of uncertainty certainly in Q4. We generally have a lot of uncertainty around the holiday things from holiday spending to what our cost to fulfill normal orders would be whether issues that can come up this year's an election year. We saw some disruption in 2016, so there's a whole host of issues that generally come to bear in Q4.

I think the fact that COVID is dwarfing all of those is causing us a lot of uncertainty on our top line range. We saw continuation in Q3 of some really good trends from Q2 and we've project those into Q4. Some of the negative factors that you mentioned as foreign profitability is again. We'll see more of the brunt of the capital investment and the people investment. We had a lot of people in the last quarter and then we added another 100,000 people in October so far.

So there's that, there's generally the dynamics of Prime Day because it's a deal-oriented time period that's usually not the highest margin period and that shifted into Q4. But generally, we have really because of the calendar this year we have really built our capacity included both in facilities and people and are carrying it through the entire quarter. We carried it through Prime Day and now we're carrying it through into the rest of the quarter.

I think in other quarters you might have seen more gradual build up that would have occurred through October end and probably maximized in November and December. So that's what I would tell you on holiday again. We have our normal caveats, so there's a lot of uncertainty and things that could go right and wrong, so that's why we put a range around it. And I'm sorry, could you repeat your second question?

Doug Anmuth

Just on how you think about 2021 perhaps just CapEx build out going forward given that you've really stepped up the investment in 2020?

Brian Olsavsky

Sure. I think some of the investment things like grocery delivery and that capacity are things that we would have invested in over time and it being matched by higher order volume. So our intent is to continue to deliver a great grocery delivery experience for our customers. So that is a little bit of pull forward. Yes, we did expect to build out our logistics capacity a lot this year especially as we have been rolling out one-day delivery the middle of last year, that was setting us up for a big build this year.

So we pull forward a bit from 2021 into this year to satisfy the demand. I think we've - the logistics team is really good at in one way you're locking up long-term commitments on space and buildings. But on the other hand being able to adjust the timeline in or out to match the capacity and demand. I think at this point we're not trying to cut it close and we're erring on the side of having too much capacity and we think that's the right call. It has been this year. We'll adjust as we get through the holiday and we'll learn a lot more. Hopefully the pandemic will be in better shape as a country and globe in Q1 of next year. It's very reactionary at this point.

We've got to play the hand that we're dealt and we're trying to anticipate and keep the customer insulated from any variability. But it's challenging certainly.

Doug Anmuth

Thanks for the color Brian.

Operator

Our next question comes from Justin Post with Merrill Lynch. Please proceed with your question.

Justin Post

Great, thanks. When you look at 3Q the environment, can you help us kind of understand the best you can quantify. How much of the incremental unit sales do you think are being aided by COVID or how much is it just a natural recurring shift online that could recur and continue to grow next year? Any thoughts on that? And then same type of question for the cloud? I'm guessing there's some headwinds of lower transaction volumes for some of your customers and then maybe there's more demand from the work at home environment. So if you could give us any thoughts on both the retail and cloud and how COVID is impacting it and could there be - how that will impact next year? Thank you.

Brian Olsavsky

Sure. It's hard to predict. I would say that there's been phases of this year. Early on there were a lot of stock ups of groceries and other household supplies followed by a wave of people buying gloves and disinfectant wipes and masks. That maybe a bit of bubble that people are not going to buy as much next year hopefully that will be a good problem to have it, as that demand went down. But otherwise we're seeing Prime number engagements. So it's strengthening our Prime program. The renewal rates are going up and the engagement is going up. So people are buying more frequently and across more categories. They're using more of our digital benefit.

We like the trends on kind of connectedness to our Prime program and we think that will have lasting value. When things open up a bit more and there's more store options for people to buy from, there will be leveling of volume back to the stores I would imagine. So we think the trends are good. They've been pulled forward probably a bit from our - the adoption curves have been pulled forward from our initial - pre-COVID thinking especially on things like grocery delivery.

So your second question on the cloud. Cloud is a mixed bag right now because we're very happy with the cloud performance and we're seeing a lot of customers who are now moving to the cloud at a faster pace. It accelerated their plans. There's anomalies in different industries going on this year things like travel and hospitality are down. A lot of companies are in holding pattern in middle and some are doing really well things like video conferencing, and gaming, and remote learning, and things tied to entertainment.

So I would say that majority of the companies though are looking for ways to cut down on expenses. Going to cloud is a good way to cut down on expenses long-term. To trying to cut down on their short-term costs in the cloud, by tuning their workloads and we're helping them do that and doing the best we can to help them save short-term dollars and again tune their usage again some of our benchmark. We think that is good for the customer and therefore, it will be good for us long-term. But even and despite those actions with strong growth the year-over-year growth in absolute dollars this quarter were the largest we've ever seen and we feel good about the state of the business and the state of our sales force and their ability to drive value during this period.

We've seen a lot of companies extending their contracts with us. The backlog of multi-year deals has gone up quite a bit. It's good from a customer connectedness standpoint. Certainly each industry is going through different dynamics right now.

Dave Fildes

And you can see, this is Dave. I'll just add to that. You can see number of those significant commitments of customers called in [indiscernible] carriers, global payments and number of others. Also seeing some good engagement with governments on their recognizing need to transform tech, get their technology more nimble and innovative. Schools and universities are planning for online learning. So a lot of help we can work with customers to provide there. On the kind of from a product perspective, we're seeing significant momentum with our AWS design Graviton2 processors.

So you've got customers like SmugMug and Netflix and there's many others. But they're realizing up to 40% better price performance from the newer Amazon EC2s, the MRC T [ph] instance families. So when you compare that to x86-based instances. Those Amazon EC2 instance families are all powered by our - with our new AWS design Graviton2 processors. So really pleased with what we're seeing there in that engagement as well.

Operator

Our next question is from Heath Terry from Goldman Sachs. Please proceed with your question.

Heath Terry

Great, thanks. Just a couple of things, how should we think about where capacity utilization of the fulfillment infrastructure is at this point with the way the growth that we've seen and the wave of new warehouse announcement? What kind of CapEx is going to be necessary to sort of bring you back to what you would consider normal levels that you'd be growing from? And then there's obviously been a lot of discussion around the capacity limitation the third-party shipping networks are going to see this holiday season given demand. How much of an issue do you see that as being and given your investments and your own delivery capacity does that become a competitive advantage for you during the holiday?

Brian Olsavsky

Yes, thanks Health. I'll start with that last one yes. [Indiscernible] intertwined here so. The third-party shipping, we rely on third-party shippers. We've great partnerships around the globe with third-party shippers and we know that their capacity will be tight as well as ours. We do feel good that we've invested quite a bit in our own capacity and you just mentioned that, about half of our CapEx is going to expanding transportation. A lot of the people that we're hiring are also focused on transportation.

So we feel good that we've been able to develop that capability a lot of this year because we needed it and we're going to need it in Q4. Having said that, it's going to be tight for everyone and I think it will all be stretched and it's advantageous to the customer and probably to the companies for people to order early this year. But regardless of the order pattern we're going to do our best to get the usual excellent service to our customers.

On CapEx levels, again we've grown our fulfillment and logistics infrastructure 50% this year. We'll see again what that implies for next year. We do see continued expansion and CapEx specifically in transportation area. So that will be start of probably multi-year period where we're hiring CapEx for that. But we'll see, right now we're just focused on Q4 and giving the guidance for Q4.

Your question on capacity utilization. It's been very tight this year certainly we're able to fill up a lot of our any excess capacity in Q2 and Q3 that might have seasonally been excess. As we get into Q4 and everything stepping up. We're adding it and using it simultaneously. We had a really good test for Prime Day and we feel good about that performance in that work and we continue to add on top of that. Lots of excitement around the holiday. But we feel we're in good shape and ready to go.

Operator

Our next question is from Mark Mahaney with RBC. Please proceed with your question.

Mark Mahaney

Thanks, two questions please. How should we think about these $4 billion expenses in the fourth quarter, $7 billion year-to-date like? Do you view them more as one-time-ish or just overall increases as you built out the network? Are they structural or one-time-ish I really want to get at that? Secondly international segments been nicely profitable or reasonably profitable for two quarters in a row. Is there some reason to think that's sustainable? And I'm sorry, third question. The other revenue growth accelerated to 49% can you give any color behind that? Thanks a lot.

Brian Olsavsky

Hi Mark, thank you. Let me start with the COVID question. So we have again, our expenses in Q3 were estimated to be around $2.5 billion and we're seeing closer to $4 billion in Q4. The majority of that is due to the expansion of our operations. So things like productivity that. There's productivity drags for things like new hire ramp, social distancing, extending break periods, things that we can quantify, said look this is a change in our process that has hurt productivity. We also have cost related to - so those are calculated that. There's more direct cost around cleaning and supplies, testing and those are the main things I would say.

So what we're trying to do by capturing these cost as to show what is, we believe is incremental and the intent is that these for our own knowledge as well that these will once the pandemic is over hopefully that soon, that these should be cost that don't recur. Okay. We know that simultaneously there's some benefits going on right now. There's things like in Q2 we had lower marketing expense you see that in our trends. It's starting to come back in Q3 and Q4 to more normalized levels but certainly everyone. There's not a lot of requirement or need to do marketing this year for parts of the year.

We saved nearly $1 billion in travel this year because travel's ground to a halt, internal travel, travel on expenses. So there's things like that will resume at a later date and maybe not get to the same levels as the past. But there won't be as artificially low as this year. So we're trying to be transparent as best we can on the cost we're seeing. We're [indiscernible] netting against some of the favorability's from demand and some of the other cost that might be offsetting although they're not offsetting to the extent that they COVID costs are sitting there.

And then I'll point the fact that because we're running at such a high level and at consistently high level really in off peak periods. We have been able to run these warehouses very efficiently. You have to split the discussion kind of between the cost penalty on the COVID related issues. But then there's certainly been some favorability from running assets more fallout condition. Okay, so hopefully that gives you some color on it.

International segment profitability. I would say and I think we discussed this a bit last quarter. We're seeing an advancement of volume and very strong volume if you will in especially in our countries in Europe and Japan. So we maybe putting in a way future volume onto this year's cost structure. So that is probably why you're starting to see that is why you're seeing profitability in international. I would say generally we're still investing ahead of the US in a lot of dimensions internationally things like Prime benefits, things like the devices, things like international expansions. You might have seen that we just launched in Sweden yesterday.

There's a lot of competing factors going on right now internationally. But I think right because of the high volumes and the leverage we're seeing and particularly in places like the UK and Germany it creating profitability ahead of schedule if you will. But we should get about the level of investment that continued and we see that we're committed to continuing that even after the pandemic and including the international segment of course is India where we've had a very strong Prime Day and Diwali is off to a good start and so anyway.

The third comment was on other revenue. Yes that is essentially getting mostly advertising and we had very strong advertising performance in Q3. So continuation of the trends that we saw in Q2. We start to see advertising budgets increase from some of the contraction that had occurred earlier in Q2 and we just had a lot more traffic and we do a good job of turning that traffic into valuable real estate for our advertisers and for our customers to find out more about selection and brand discovery. So most of that is with strong quarter in advertising and that's what you're seeing in the other revenue line.

Operator

Our final question will come from Eric Sheridan with UBS. Please proceed with your question.

Eric Sheridan

Thanks for taking the question. Maybe two, if I can. One following up on Mark's question on the advertising side. You know we continue to see you guys innovate a lot on the product side especially with programmatic advertising, video advertising. Can you just give us a little bit of sense of how you see the advertising offering both on Amazon and off Amazon sort of evolving in the years ahead? And the second question would be coming back Brian to your comment in the opening remarks around Prime video and all the consumptions you've seen globally in the recent past. How does that help inform what do you think about in terms of the opportunity when invest against original content to continue to drive that sort of medium consumption loop within the Prime membership. Thanks so much.

Brian Olsavsky

Yes, great. Eric I'll start off with the questions on advertising. So just to ground you and I think our main priorities here at the space and some of these probably aren't too surprising is, we're focused on making our tools easier to use. Sponsored ads, sponsored brand site, a bidding sponsored product targeting. Working on just simplifying registration for agencies and marketers, getting set up. But we're also very focused on being smarter about servicing more relevant ads to customers.

Making display ads easier and then increasing usability to Amazon demand site platform. So we've been working on a number of those areas and then developing new products and a lot of that's focused around, how are we serving brands from various areas Twitch [ph] sponsored brands, stores of course, so another interesting area. We're certainly in a unique position to be able to provide measurement services that help all these brands or understand the impact of other advertising in ways they're going to help them grow their business.

Video, you mentioned I think video is one that's we're working hard on with some of the OTT video advertising opportunities there. We're seeing some good momentum with that. We offer inventory and IMDB TV, ad supported space and 3P apps [indiscernible] pulling off the Fire TV. I think good momentum and a lot of good learning on some of those initiatives there. I won't say too much about what we'll look like next year in the future but that gives you kind of sense of priorities where we're spending our time and focused on.

Dave Fildes

And your question on video, so we step back in our goals to deliver high quality and fresh content to our global Prime member base. We're doing that by producing top tier US content that we show globally and then we augment that with local originals in each region. If we do that job well - we've seen it as a very significant acquisition channel from new Prime members especially in many smaller countries around the world. We see higher free trial conversion rates. Higher membership renewable rates and then higher overall engagement as I mentioned in Q3 specifically. And when they do that, when the more engaged they are, we know that, that turns into more sales on Amazon and it's a self-reinforcing loop.

So we're very happy with the video performance particularly during this period. I think people have gotten really good chance to test out the content maybe Prime members [indiscernible] that benefit as much in the past, have given another look and have you know really found value in it. We're in more than 240 countries and territories worldwide and again we're seeing some really interesting localized content developing in places like India, Brazil, Mexico, Australia, UK and Spain which I think the customers in those countries really appreciate.

Dave Fildes

Great, thanks for joining us today for the call and for your questions. A replay will be available on our investor relations website for at least three months. We appreciate your interest in Amazon and we look forward to talking with you again next quarter.