GRANT'S

INTEREST RATE OBSERVER®

Vol. 32, No. 02a — Two Wall Street, New York, New York 10005 • www.grantspub.com — JANUARY 24, 2014

So close to the sun

Jeff Bezos has set out to create the "everything" store. Unfinished though that universal quest may be in the narrow retailing sense, it's a *fait accompli* in the grand, monetary sense. On the one hand, Amazon's zooming share price is a study in asset inflation. On the other hand, Amazon's margin-crushing, bookstore-demolishing, customer-pleasing merchandising strategy is a visible source of price deflation. In the age of QE, Amazon is the everything enterprise: fire and ice in a single ticker.

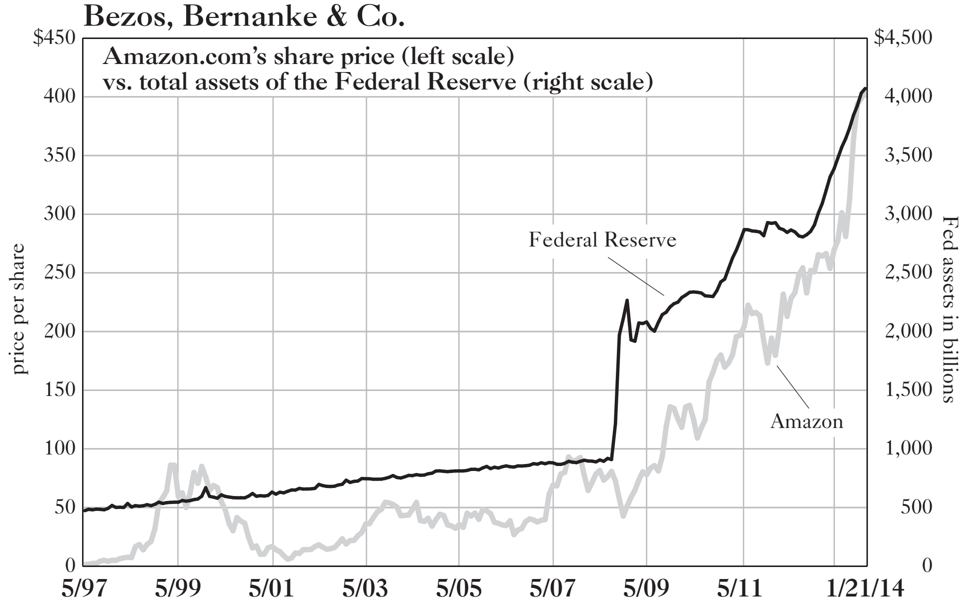
Now under way is a rumination on the effect of the Federal Reserve on Amazon, and of Amazon on the Federal Reserve. It's a coda to the page one story in the previous issue of *Grant's*. As you may recall: Prices should be falling in a time of technological wonder, or so we contended. If it costs less to produce things (and services, too), it should cost less to buy them. Today's monetary authorities move heaven and earth to resist this benign tendency. Deflation is an "ogre," declared Christine Lagarde, managing director of the International Monetary Fund, at the National Press Club last week. Just what grudge she holds against everyday low prices, Lagarde didn't say. Whatever it is, she would probably get an argument from Bezos and his customers alike.

The trillion-dollar question is whether the central bankers will wind up getting more inflation than they bargained for. We note that, according to the Conference Board, global labor productivity growth decelerated in 2013 for the third consecutive year and that, in the United States, the capacity utilization rate for December rose to 79.2%, the highest in five years. What kind of inflation do the bureaucrats wish to raise up? In America, both kinds: the stock-market variety to foster the confidence that leads to a faster pace of consumption and the checkout-counter kind to protect against a return to the economic environment of "The Grapes of Wrath." The Feds are shooting for a rate of rise of 2% a year in consumer prices. They don't disclose the rate of rise they prefer for stock prices. Whatever it is, they seem to be hitting it.

Amazon has to figure among the central bank's warmest friends and worst enemies. To any who preach the gospel of the "portfolio balance channel" (rising asset prices lift all boats, supposedly), AMZN, the share price, is a thing of beauty. It just goes up. The Bezos shares change hands at 1,454 times' trailing net income and 50 times' enterprise value to EBITDA, which is to say earnings before interest, taxes, depreciation and amortization. Amazon's stock-market capitalization stands at $186.3 billion. Not one of the 47 security analysts who follow the company rates it a sell, according to Bloomberg; 11 have the temerity to say "hold." To declare an interest, your editor is a limited partner in a fund that's short the stock.

Ben Bernanke, a great one for the portfolio balance channel, could hardly ask for more, though, perhaps, he hopes for more. As it is, the Dow Jones Industrials change hands at 16 times earnings. Collectively, they command a $4.7 trillion market value. If all traded at the Amazon multiple, the 30 would sell for

Bezos, Bernanke & Co.



source: The Bloomberg

$459.1 trillion, or six times more than annual worldwide GDP. Just think of the latent spending power in that bit of portfolio balance channeling, the outgoing chairman might ruminate.

Attendees at the annual convention of the National Retail Federation in New York last week were rather ruminating on their own survival. According to a Jan. 15 dispatch by Lydia DePillis in the Bezos-owned *Washington Post*, the hottest ticket at the conference was a lunchtime briefing about Amazon. People were sitting on the floor and standing in the aisles, DePillis relates, and she quotes the speaker, Lee Peterson of WD Partners, thus: "If you don't think Amazon is a problem for your business, I don't care where you are in the world, you are wrong, you are living under a rock. It's time to come out."

What's to be frightened of? "Nothing," a grateful Amazon customer might reply. "The most predatory aspirational monopolist since John D. Rockefeller," a Best Buy executive, alluding to Amazon's founding genius, might counter. "Deflation," a scholarly Federal Reserve economist might quietly interject (economics being a science and scientists being coolly impartial, supposedly).

Open before us is a copy of "The Everything Store," by Brad Stone, a 2013 book about Amazon. Reading it—and it is a pleasure to read—one was not surprised by Friday's news that Amazon has filed a patent for something it calls "anticipatory package shipping." The point of the invention seems to be that there's no sense waiting for the customer to order when you already read the customer's mind.

Like Sam Walton, the founder of Wal-Mart, and Jim Sinegal, the progenitor of Costco, Bezos strives to amaze and delight the consumer. Since people like to save money, Bezos has built a business around the concept of savings: savings of time, money and aggravation. He has deployed shopping bots, robots, apps, warehouses and warehousemen in the service of low prices. So doing, he has made some not unimportant incremental contribution to thwarting the Fed in its pursuit of its peculiar definition of "price stability." Stone reports on business meetings during which Bezos makes "a big show of keeping one chair open at the conference-room table 'for the customer.'"

Amazon.com Inc
(in $ millions)

	2012	2011	2010	2009	2008	2007
Accounts receivable	$3,364	$2,571	$1,587	$988	$827	$705
Inventory	6,031	4,992	3,202	2,171	1,399	1,200
Accounts payable	13,318	11,145	8,051	5,605	3,594	2,795
Working capital	(3,923)	(3,582)	(3,262)	(2,446)	(1,368)	(890)
As percnetage of sales	-6.4%	-7.5%	-9.5%	-10.0%	-7.1%	-6.0%
Days sales outstanding	20	20	17	15	16	17
Days inventory	48	49	44	42	34	38
Days payable	106	109	111	108	88	89
Cash cycle	(38)	(41)	(50)	(51)	(38)	(33)
Cash from operations	$4,180	$3,903	$3,495	$3,293	$1,697	$1,405
Capital expenditures	(3,785)	(1,811)	(979)	(373)	(333)	(224)
Free cash flow	395	2,092	2,516	2,920	1,364	1,181
Sales	61,093	48,077	34,204	24,509	19,166	14,835
y-o-y sales growth	27%	41%	40%	28%	29%	39%
Net income	$(39)	$631	$1,152	$902	$645	$476
Cash	11,448	9,576	8,762	6,366	3,727	3,112
Debt	4,385	2,299	1,032	430	468	1,325
Net debt	(7,063)	(7,277)	(7,730)	(5,936)	(3,259)	(1,787)

source: The Bloomberg

The stockholder is virtually present at these gatherings, too, if we read Stone correctly. This is so because, by Bezos's lights, what's good for the customer is good for the stockholder. "That either-or mentality, that if you are doing something good for customers it must be bad for shareholders, is very amateurish," the author quotes his subject as saying.

What's been bad for the Amazon shareholder is bear markets—that and only that over the past decade-and-a-half. In just three weeks in June 2000, the price of AMZN broke to $33 from $57. Bezos kept up a brave front, scrawling, "I am not my stock price" on the whiteboard in his office. "You don't feel 30% smarter when the stock goes up by 30%," Stone quotes the visionary as telling the Amazon team during those dark days, "so when the stock goes down you shouldn't feel 30% dumber."

But when the stock goes up by 700% in just five years, as Amazon's has done, the average mortal might be inclined to feel smarter. Especially might those feelings wash over a body when, over the same five-year span, earnings per share declined at a compound annual rate of 29%. Watching the diverging trends of share-price appreciation and EPS depreciation, an observer might easily conclude that Amazon occupies its own special world with rules to match.

And one would be correct to this extent: Amazon funds itself by growing. It collects money from its customers in 20-odd days. It holds its inventories for not quite 50 days. It pays its vendors in 100-odd days. Nearby is a snapshot of Amazon's financial position. At year-end 2012, accounts receivable came to $3.4 billion, inventory to $6 billion and accounts payable to $13.3 billion. So despite minimal net income under generally accepted accounting principles, Amazon funds capital spending through operations. The year-end 2012 balance sheet showed $7.1 billion in net cash.

Put yourself in Bezos's shoes. In Amazon stock alone, you are worth $34 billion. They are writing books about you. Some people admire you, others fear you. You own the newspaper that Eugene Meyer and Katharine Graham built—and that digital technology, essentially your technology, unbuilt. You have changed the world. What next? What's next is a physical monument, Amazon's new, daring, greener-than-green, larger-than-life Seattle headquarters.

On Christmas eve, National Public Radio reminded its listeners that 2013 was the year of the techno-edifice. Apple, Facebook, Google—and Amazon—simultaneously broke ground for new corporate offices. Amazon is building in downtown Seattle. Three city blocks will accommodate three 38-story office buildings surrounding three glass domes—terrariums of a kind—in which fully grown trees will shade, refresh and inspire the Amazon headquarters staff, including 12,000 anticipated new hires. Completion is slated for 2017.

What might the budgeted 3.3 million square feet of office space cost? No estimates have been published just yet, but paid-up subscriber Paul Isaac—an Amazon bear, let the record show—has an observation and a supposition. He points out that Amazon has earned cumulative net income of less than $2 billion ($1.964 billion through the third quarter of 2013, to be exact) since its founding in 1994. Not a lot of money for a business that has made such a noise in the world. And it would not be surprising, Isaac goes on, "given the complexity and novelty of the construction in a relatively high-cost area," if the final price tag on the new corporate village winds up absorbing both of those lonely two billions. "Twenty years in business, all this—as yet—unprofitable activity," Isaac marvels, "and they are going to blow the cumulative shareholders' net earnings on a snazzy new HQ?"

"The Everything Store" relates how Bezos once exploded in rage at a suggestion that the company's frequent flyers be allowed to fly business class. The man who proposed the big idea, Bill Price, vice president in charge of customer service, is quoted as to what happened: "You would have thought I was trying to stop the Earth from tilting on its axis. Jeff slammed his hand on the table and said, 'That is not how an owner thinks! That's the dumbest idea I've ever heard.'"

This was apparently in the year 2000, when Bezos was concentrating on not becoming his (plunging) stock price. Perhaps in the case of not becoming his (surging) stock price, the founder sold 2,193,115 Amazon shares for pre-tax proceeds of $711,159,646 in 2013. The book quotes a longtime Amazon executive, Rick Dalzell, saying that Bezos is inoculated against conventional thinking: "What is amazing to me is that he is bound only by the laws of physics."

Not flying too close to the sun is one such law. Especially is it relevant in a time of federally powered bull markets. Among all the companies in the S&P 500 for which Bloomberg has data, Amazon's trailing 12-month P/E ratio—the aforementioned 1,454 times—ranks highest. Something's got to give. We have a hunch it's going to be the Amazon multiple.

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