Amazon soars as digital sales boost margins

Alistair Barr, Reuters

(Reuters) - Amazon.com Inc's stellar quarterly results are helping convince skeptics on Wall Street that a bout of intense spending is beginning to pay off for an Internet retailer trying to transform itself into a technology company.

Shares in Amazon leapt 15 percent on Friday after it reported first-quarter earnings [1] and margins well above investors' most bullish expectations, tacking on some $10 billion in market value and marking its biggest single-day gain since October of 2009.

CEO Jeff Bezos has tried to convince investors to stick with the company for the long term as it flirted with losses in recent quarters. He is trying to transform Amazon from an online version of a big-box retailer like Wal-Mart into a provider of technology services.

Some investors argue that its valuation of over 70 times forward earnings -- dwarfing companies like Apple Inc and Google Inc that produce record profits -- is justified because Amazon is on track for enormous margin expansion as it expands into more-profitable services from hosting websites in the cloud to providing an online marketplace connecting buyers and sellers.

"These services will become an increasingly important part of Amazon's overall business and will be a driving force of profitability going forward," Bernstein Research analyst Carlos Kirjner wrote.

Amazon is trying to be "not a bookseller or a retailer, but a company that uses technology and (now) its scale to transform whole value chains" from retail to publishing and video distribution.

Heavy spending has pressured profit margins in recent quarters, hitting the company's shares. But in the first quarter, gross margins rose by about 120 basis points to roughly 24 percent, Macquarie analyst Ben Schachter estimated.

Amazon shares rose to $225.75 on the Nasdaq [2].

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That surprise increase in gross margins prompted a flurry of price target increases by analysts.

Faster growth at its online marketplace business and cloud unit Amazon Web Services, along with sales of digital goods, drove the improvement in margins, analysts said.

Amazon's 34 percent revenue increase to $13.18 billion also impressed Wall Street which had expected revenue of $12.9 billion, according to Thomson Reuters I/B/E/S.

"The biggest surprise in the quarter was Amazon's gross margin increase of 120 basis points year-over-year, the largest uptick in 10 years," RBC Capital Markets analyst Ross Sandler said.

During the first quarter, nine of the 10 top-selling products on Amazon.com were digital products, including Kindle e-books, movies, music and apps.

"Bulls have been waiting a long time for this gross margin upside and it finally came in the first quarter," Macquarie Equities Research analyst Ben Schachter said.

The company's shares had been hit by margin pressure over the past few quarters.

Schachter expects gross margins to continue to ramp up in the long term as the company benefits from the increasing use of the Internet.

Analysts at Macquarie, RBC, Citigroup and at least nine other brokerages raised their price target on the stock. Nomura upgraded it to "buy" from "neutral.

According to Thomson Reuters StarMine, 12 analysts rate the stock "strong buy," 11 a "buy," 15 a "hold" and one a "sell." Only one rates the stock "strong sell." Analysts have a mean price target of $218.69.

The company released its quarterly results after the market's close on Thursday.

(Editing by Phil Berlowitz)

Links:
[1] http://www.reuters.com/finance/earnings
[2] http://www.reuters.com/finance/markets/index?symbol=us%21comp