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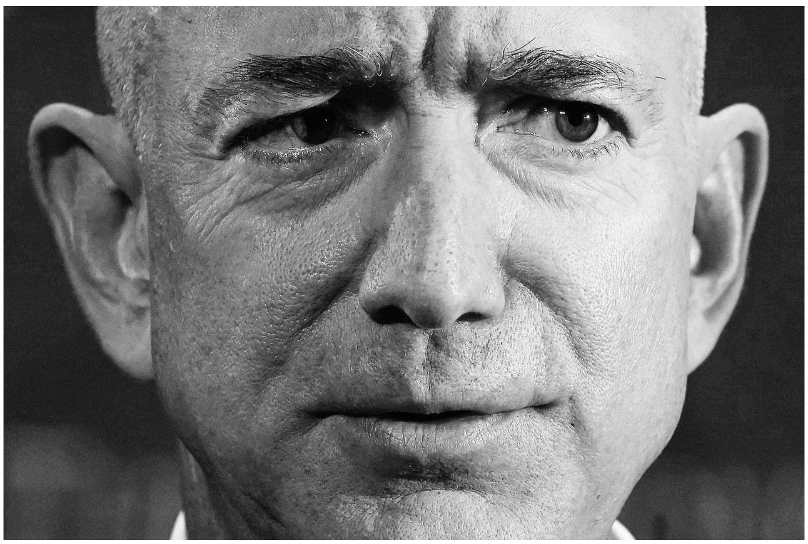
The Case for Breaking Up Amazon



Jeff Bezos *PHOTO: ALEX WONG/GETTY IMAGES*

By Nicholas Jasinski Sept. 19, 2018 7:00 a.m. ET

Amazonhas long been more than just the world's largest e-commerce company: Its Amazon Web Services (AWS) cloud computing division is also the global leader, with a 2017 market share larger than that of competitors Microsoft, Alphabet,and IBMcombined. And while AWS brought in less than 10% of Amazon's revenue last year, it was responsible for more than 100% of its operating income. The aggressive investment in — and low margins of — retail actually lost Amazon money.

In a report this week, Citi Research analyst Mark May explored the pros and cons of splitting the trillion-dollar company into two separate entities. He estimated that Amazon's retail business would constitute the lesser half, worth $400 billion, while the cloud computing division could command a $600 billion valuation on its own.

> With big tech companies facing increasing public scrutiny and Amazon the preferred target of President Donald Trump, May wrote that the company could get ahead of any government action:

"By separating the retail and AWS businesses, Amazon could minimize or avoid the risk of increased regulatory pressure." Amazon has a less than 5% share of the U.S. retail industry, already making an antitrust argument a difficult one, however.

That retail competitive presence poses perceived conflicts of interest for AWS, according to May: "For instance, Target announced last year that it planned to scale back its use of AWS starting and increase its use of Google Cloud as an alternative vendor. And, following Amazon's acquisition of Whole Foods, Krogerstated in late 2017 that it would transition away from AWS and invest more heavily with MicrosoftAzure and Google Cloud." Separating the businesses would indeed reduce this concern, but the majority of AWS' clients probably aren't worried anyway.

Having two unrelated business lines with separate sales and profit drivers means that the value of an Amazon employee's stock options can fluctuate based on the performance of a division they don't work in. By splitting retail from AWS, "Amazon could better align its stock-based incentive compensation" to the units its employees have an influence on, May wrote. Explosive AWS growth has driven a significant amount of Amazon's stock gains in the past few years, but May notes that in 2014, shares fell 22% after disappointing AWS results, while retail had a strong year.

Other pros of splitting that May points to include planning for CEO Jeff Bezos' succession, potentially achieving an even better valuation, and improving shareholder selection for those preferring an e-commerce or cloud computing pure play.

It's not all potential benefits, however. May notes that a spinoff of one of Amazon's businesses would eliminate existing synergies, distract management, and might not produce an incremental return given that the company already provides significant data for each segment that allows investors to value Amazon using a sum-of-the-parts framework.

May summed up his last caveat to an Amazon split with a maxim: "If it ain't broke, don't fix it."

A version of this article first appeared in Review & Preview, a daily email from Barron's. Sign up here and every evening we'll review the news that moved markets during the day and look ahead to what it means for your portfolio in the morning.

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