Down 30% From Record Highs, Is Amazon (NASDAQ:AMZN) Stock a Buy?

Description

The ongoing selloff in the equity markets has dragged shares of **Amazon** (NASDAQ:AMZN) lower by 30% from all-time highs. However, the pullback in AMZN stock offers investors an opportunity to buy a quality company at a lower valuation.

Valued at a market cap of US$1.33 trillion, Amazon is still one of the largest companies in the world. So, let's see if the tech stock should be part of your equity portfolio right now.

The bull case for Amazon stock

Amazon continues to lead multiple business verticals that are expanding at a rapid pace. It is the world's largest e-commerce player and accounts for almost 40% of total online sales south of the border. Amazon is also a market leader in segments such as public cloud, online streaming, and digital advertising.

Earlier this month, Amazon increased sales by 7% year over year to US$121 billion, outpacing estimates of US$119 billion. Its cloud division, also known as Amazon Web Services, led top-line growth, as sales rose 33% to US$19.7 billion in this business. Amazon ended the second quarter (Q2) with an operating income of US$3.3 billion, again surpassing estimates of US$1.75 billion.

To diversify its revenue base, Amazon has gone bottom fishing amid challenging macro conditions and acquired companies at a discount. Last month, Amazon signed an agreement to purchase **One Medical**, while it announced the acquisition of **iRobot** on Aug. 5. These big-ticket deals should allow Amazon to diversify its revenue stream, allowing the company to enter industries such as healthcare and consumer robotics.

In fact, iRobot has a popular portfolio of robot vacuums that should enable Amazon to expand its presence in the smart home market going forward.

Amazon generates significant cash flows from its higher-margin sales channels, including cloud infrastructure, advertising, and Prime subscriptions. For example, Amazon Prime has over 200 million subscribers globally, providing customers with faster and cheaper shipping options and access to streaming content. This vertical brings in close to US$30 billion in sales each year and will bring in substantial cash flows in the upcoming decade.

Amazon Web Services accounts for 33% of total cloud-service revenue, according to market research company Canalys. This business is also Amazon's most profitable one and should drive margins higher over time. In the first six months of 2022, Amazon Web Services generated 16% of total revenue but accounted for all of the company's profits.

Additionally, while most digital ad companies, including **Alphabet** and **Meta Platforms**, are wrestling with tepid sales, Amazon's online ad business has performed exceptionally in 2022.

The bear case for AMZN stock

While AMZN stock is trailing the broader markets in the last year, it continues to trade at a premium. Analysts expect Amazon sales to increase by 11.2% to US$522.4 billion in 2022, but adjusted earnings per share is forecast at $0.05 compared to $3.24 in the year-ago period.

We can see that Amazon stock is valued at less than three times forward sales, which is reasonable, but its price-to-forward earnings multiple is extremely steep due to rising operating expenses.

The earnings decline is a short-term headwind for the e-commerce giant, and Amazon remains a top bet for investors. Analysts are bullish on AMZN stock and expect it to gain over 30% in the next 12 months.

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