Amazon’s Expansion Costs Take a Toll as Profit Falls 77% 
Retailer pours funds into new warehouses, data centers and Alexa service

By Laura Stevens
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Amazon.com Inc. said quarterly profit fell 77% even as sales jumped, a sign of the high cost of its increasing dominance of retail.

The Seattle-based retailer eked out its smallest quarterly profit in nearly two years. The company reported $197 million in profit on $38 billion in sales in the second quarter as it spent on new warehouses and delivery capacity for its retail business and data centers for its cloud services business. The company also poured funds into hiring engineers to work on its artificial intelligence Alexa service as well as warehouse workers.

“We are continuing to invest in businesses that will achieve four goals...Customers love them, they can grow to be large, they have strong financial returns and they are durable and can last for decades,” Chief Financial Officer Brian Olsavsky said on a media call. “That is, in essence, our investment philosophy.”

Amazon’s 25% sales growth comes at the expense of traditional retailers, which are struggling with declining foot traffic and the shift of consumer spending online. At a time when Amazon is investing heavily and expanding, other retailers are saddled with high debt loads and falling sales, forcing them to close stores and cut jobs—and extending Amazon’s advantage.

“Amazon is a great disrupter in traditional retail,” said Trip Miller, founder and managing partner at Amazon investor Gullane Capital LLC. “Everyone is pivoting and trying to change their game to deal with Amazon. I would hate to be the competition in anything they get involved in.”

Amazon’s stock price was down 2.3% in after-hour trading as the company missed profit and guidance expectations, a tempered reaction given that other retail stocks often drop in the double digits when Amazon makes a move to compete in the same market. Amazon shares, which finished Thursday at $1,046, were up about 39% year-to-date at the close.

High expectations for Amazon temporarily made founder and Chief Executive Jeff Bezos the world’s richest person on Thursday. Amazon’s stock hit a record in the morning ahead of the results, edging Mr. Bezos in front of Microsoft Corp. founder Bill Gates, before closing down. According to Forbes, which tracks a list of billionaires, Mr. Bezos reached a net worth of $90.6 billion as the market opened.

Amazon is now making a big push into brick-and-mortar, something expected to further hurt traditional retail competitors. Last month, Amazon announced a $13.7 billion including debt acquisition of Whole Foods Market Inc., immediately catapulting it into a major player in brick-and-mortar retail and grocery. Whole Foods reported Wednesday that comparable sales fell again in its latest quarter, a trend it has promised to reverse by September.

Adding Whole Foods “will be a big boost for us as we expand our offerings in consumables and grocery,” Mr. Olsavsky said.

The shift from shopping in-store to online has left many powerful brands unable to ignore Amazon, increasing the retailer’s dominance. Fifty-five percent of product searches now start at Amazon, according to personalization platform company BloomReach, compared with 28% on search engines. In recent
weeks, Amazon has become an official seller for Nike Inc. and Sears Holding Corp.’s Kenmore brand of appliances.

Amazon has claimed more than 40 cents out of every dollar spent online over the past year, according to receipt tracker Slice Intelligence, which has an online shopping panel of more than 5 million. Wal-Mart Stores Inc., in comparison, claimed about 1.7% of online spending over the same period.

Amazon is now the second-largest apparel seller behind Wal-Mart after taking market share from Target Corp. and several department stores, according to a research note published by Morgan Stanley in April.

But the company’s outsize retail muscle is raising concerns about its growing size and influence. Amazon’s acquisition of Whole Foods has prompted roughly a dozen members of Congress to call for a close review of the deal. The Consumer Watchdog group is lobbying the Federal Trade Commission to block it on allegations that Amazon’s pricing discounts are misleading, assertions Amazon has called “flat out wrong.”

Mr. Olsavsky said Amazon isn’t as dominant as it may appear. “The businesses we’re in are all very large market segments, with lots of very serious competition,” Mr. Olsavsky said. “Generally the number one thing that we’ll do at all times is align ourselves with customers and continue to invent on their behalf.”

Department stores are expected to post a 12% decline in earnings when they report in coming weeks, according to FactSet, while apparel retailers are forecast to see profits drop 8.5%.

Amazon said it will continue to spend heavily on its growth, signaling a period of lower profit. That is particularly the case in the third quarter, Mr. Olsavsky said, because Amazon bulks up on warehouse staff and delivery capacity ahead of the all-important holiday season. Amazon said its operating income could swing to a loss in the next quarter.
One of the bigger costs for the quarter will come from hiring new employees, part of its **pledge to hire 130,000 U.S. workers** through mid-2018. The company said on Wednesday it plans to host a giant job fair next week to hire for its 50,000 current U.S. warehouse openings. Amazon said Thursday that its global workforce rose by more than 31,000 in the second quarter to 382,400.

The company may also have to pay its new warehouse hires more thanks to a tight labor market in many logistics hubs as retailers and delivery companies compete for the same small pool of workers.

Amazon's cloud-computing division continues to be the engine behind the retail giant's profits. Amazon Web Services' operating income of $916 million topped total operating income for the entire company, which hit $628 million in the period. Even so, AWS, which competes against Microsoft and Alphabet Inc.'s Google, marked the fifth consecutive quarter of declining operating income growth, which gained 28%.