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Solving the Amazon Puzzle

In a battle of tech titans, some investors may have reason to prefer Bezos over Brin and Page.

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Which company is a better investment, Google or Amazon.com? Conventional wisdom suggests Google, which turns huge profits, enjoys better gross margins, and has a far lower price-to-earnings ratio. Yet Amazon's stock has returned 62.6 percent in the past year, compared with 9.6 percent for Google.

That's a phenomenon Steve Hanke, an economics professor at Johns Hopkins University, and Ryan Guttridge, a fellow there, have named the "Amazon Puzzle," and one they say they've figured out. The key is hidden in asset turns, or how effective companies are at getting revenue out of their investments. Asset turnover is defined as sales divided by total assets; the higher the number, the better. "Google is just abysmal, and Amazon is really good," says Guttridge, who once worked for legendary stock picker Bill Miller at Legg Mason in Baltimore.

How abysmal? Try 0.54 in 2013, 0.55 in 2014, and 0.53 so far this year, versus 2.05, 1.88, and 2.12 for Amazon, according to data compiled by Bloomberg.

Guttridge and Hanke credit Amazon's cash flow–focused CEO, Jeff Bezos. Bezos has a salary of just $81,840 a year, though he gets a further $1.6 million to cover his personal security. Beyond that, he receives nothing atop the return on the 18 percent of Amazon that he owns. It's the same stock shareholders own. He makes money only if the stock goes up and must keep shareholders happy or be held accountable. Larry Page and Sergey Brin of Google, while they earn only $1 a year in salary, control classes of stock outside investors can't touch.

That puts Google's lucrative search and YouTube services further out of reach of the little guy. And that's why Guttridge is betting on Bezos. "You buy equities because you expect to benefit from the free cash flow of the business," he says. "With Amazon, you have a clear line between asset turns and cash flow."