


[Previous Page](#)

Which Stock Falls First?

<http://www.fool.com/investing/general/2011/01/18/which-stock-falls-first.aspx>

Rich Smith
January 18, 2011

"The bigger they are, the harder they fall." It's the worst nightmare of every investor in today's market -- buying a rocket stock just before it takes a nosedive.

Every day, finviz.com publishes a list of stocks whose shares have just hit new 52-week highs. Every day, investors read the list and tremble -- some with greed, others with terror. Within our [Motley Fool CAPS](#) investing community, these top stocks generally enjoy favorable ratings, since everyone loves a winner ... but not always:

| Company | 52-Week Low | Recent Price | CAPS Rating (out of 5) |
|---|-------------|--------------|---|
| Weatherford (NYSE: WFT) | \$12.34 | \$23.93 | ***** |
| Schlumberger (NYSE: SLB) | \$51.67 | \$86.91 | ***** |
| National Oilwell Varco (NYSE: NOV) | \$32.18 | \$69.31 | ***** |
| Melco Crown Entertainment (Nasdaq: MPEL) | \$3.30 | \$7.55 | **** |
| Amazon.com (Nasdaq: AMZN) | \$105.80 | \$188.75 | ** |

Companies selected by screening for new 52-week highs hit on the Thursday before publication. Low and recent price provided by Yahoo! Finance. CAPS ratings from [Motley Fool CAPS](#).

Whenever a stock is seen hitting new 52-week highs, investors naturally wonder how long the good news can keep coming -- the law of gravity being what it is. Still, CAPS members seem unconcerned about the valuations on most of the stocks making up this week's list.

Disregarding price-to-earnings ratios that sometimes seem on the high side (Weatherford, for example, costs nearly *425 times* last year's profit), it appears investors are hanging their hopes on the future. Over at **Goldman Sachs**, for example, the [professional petroleum prognosticators](#) are once again calling for [\\$100-a-barrel oil](#) in 2011. If that's how things play out, perhaps the consensus predictions of near-20 forward P/E's and midteens growth among oil services companies will prove attainable.

Likewise with Melco Crown. Bullish supporters of this play on Chinese gambling tourists will argue that [China changes everything](#). (After all, there's like, 3 trillion people living there, right?) Personally, [I'm as suspect of cash burning companies as ever](#), but there's no denying the stock's popularity.

Which brings us, at last, to Amazon.com. The sole stock on today's list that *fails* to elicit positive sentiment on CAPS (two stars is a substandard rating), it seems a lot of folks out there are betting on Amazon to fall. What's got 'em feeling so down on the stock? And more importantly, what might cause Amazon's share price to fall back to earth? That's what we aim to find out, as we sign in to ...

The bear case against Amazon.com

Rarely has a company elicited such conflicting emotions from investors, as does Amazon.com. CAPS All-Star linuslaser calls Amazon an "excellent company," but "[far overpriced](#)." Fellow All-Star jstegma2 boggles at the stock's P/E ratio, which "is just [way too high](#)."

Echoing the theme, Elemanxx990 practically pleads: "I love Amazon and am a loyal customer. I do find the P/E to be alarming which is why I am out." That said, "if the stock bottoms out at [\\$120-140](#) in the next year I may well get back in."

In other words, Amazon.com is a really, really great company that a lot of folks would love to own, if it didn't cost so dang much. It's the proverbial "[great company, lousy stock price](#)" dilemma. But how overvalued *is* Amazon, actually? And what might it take to cause the stock to fall back to Elemanxx990's hoped-for "\$120-140" price range?

The answer to the first question is pretty easy. At 77 times trailing earnings, and 46 times trailing free cash flow, Amazon is pretty obviously overpriced -- even if you agree with consensus projections of 27% long-term earnings growth.

And if we don't?

If you *disagree* with Amazon's growth prospects, on the other hand, the stock looks even more expensive. CAPS member mrkhan1024 for example, warns that "margins will continue to stay tight just by the very nature of doing business on the internet and with companies like **Wal-Mart** [(NYSE: [WMT](#))] and **Best Buy** [(NYSE: [BBY](#))] gaining [share in the dotcoms](#)." And indeed, if you take a close look at Amazon's margins, then from an operating and net profit margin perspective, at least, there does seem to be some slippage apparent in the most recent quarter.

The bigger threat to Amazon, however -- at least to my Foolish eye -- is the Great Recession, and the need it's created in state treasuries across the nation to find [new sources of revenue](#). Amazon is finding itself hauled time and again into court to contest state efforts to make it collect sales taxes. In some cases, the company can dodge the legal bullets by simply cutting ties with local retail partners, and pulling up stakes from the affected states.

Foolish final thought

But as more and more states try to exact their pound of flesh from the e-tailer, I expect this strategy [will eventually fail Amazon](#). Eventually, it's going to have to concede to the need to collect state sales taxes on its goods -- crimping its ability to undercut rivals (like Wal-Mart and Best Buy) on price. And when *that* happens, I expect we'll see growth projections revised downward, and we'll see the "multiple" investors are willing to pay for the stock, compressed -- maybe even compressed enough to give Elemanxx990 that second bite at Amazon's apple, [at a more attractive price](#).

Do *you* see a different future for Amazon? Tell us about it [on Motley Fool CAPS](#).

[Legal Information](#). © 1995-2008 The Motley Fool. All rights reserved.

[Previous Page](#)