Consumer Discretionary

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Overview

- Businesses that sell nonessential goods and services
- 86 companies from sector in S&P 500
- $4.36 trillion in market capitalization
- 12.80% of S&P 500
Industries within Sector

- Retailers
- Media Companies
- Consumer Services
- Consumer Durables and Apparel
- Hotels, Restaurants, and Leisure
- Automobiles and Components
Sector’s Largest Companies (Market Cap.)
Sector Performance (YTD/QTD)
Business Analysis

- Business Cycle
- Economic Influences
- Porter’s Five Forces
Business Cycle

- **Early**
  - Activity rebounds (GDP, IP, incomes)
  - Credit begins to grow
  - Profits grow rapidly
  - Policy still stimulative
  - Inventories low; sales improve

- **Mid**
  - Growth peaking
  - Credit growth strong
  - Profit growth peaks
  - Policy neutral
  - Inventories, sales grow; equilibrium reached

- **Late**
  - Growth moderating
  - Credit tightens
  - Earnings under pressure
  - Policy contractionary
  - Inventories grow; sales growth falls

- **Recession**
  - Falling activity
  - Credit dries up
  - Profits decline
  - Policy eases
  - Inventories, sales fall
## Economic Influences

<table>
<thead>
<tr>
<th>Sector</th>
<th>Early</th>
<th>Mid</th>
<th>Late</th>
<th>Recession</th>
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</thead>
<tbody>
<tr>
<td>Consumer Discretionary</td>
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**Positives:**
- Low Unemployment
- Consumer Confidence
- Wage Growth
- Lower Commodity Costs
- Accommodative Monetary Policy

**Negatives:**
- Fierce Retail Competition
- Changing Consumer behaviors
- Higher Fed Rates
- Poor Economic Conditions
## Porter’s Five Forces

<table>
<thead>
<tr>
<th>Power of Suppliers: Medium</th>
<th>Power of Buyers: High</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Depends on Industry</td>
<td>• Consumers have many options</td>
</tr>
<tr>
<td>• Weaker with strong union presence (Auto and Movie)</td>
<td>• Low Switching Costs</td>
</tr>
<tr>
<td>• Varies with material availability</td>
<td>• Low Loyalty</td>
</tr>
<tr>
<td>Threat of New Entrants: Medium</td>
<td>• Price Sensitive Industry</td>
</tr>
<tr>
<td>• Vary greatly by Industries</td>
<td></td>
</tr>
<tr>
<td>• Economies of Scale</td>
<td></td>
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<tr>
<td>• Large Capital Requirements</td>
<td></td>
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<tr>
<td>• Highly Competitive Industries</td>
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</tbody>
</table>

**Rivalry: High**

- Fierce Competition
- Larger companies have advantages (market share, economies of scale)

**Threat of Substitutes: High**

- Industry Dependent
- Many options and substitutes
- Non-necessary goods (consumer can decide not to buy/wait)
Economic Analysis - Fed Funds Rate
Economic Analysis - Oil Price
Economic Analysis - Consumer Sentiment
Economic Analysis - Disposable Personal Income
Economic Analysis
## Financial Analysis

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<thead>
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</thead>
<tbody>
<tr>
<td><strong>12 Months Ending</strong></td>
<td></td>
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<tr>
<td>Trailing 12M Profit Margin</td>
<td>6.95</td>
<td>7.14</td>
<td>6.81</td>
<td>7.06</td>
<td></td>
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<tr>
<td>Growth (YoY)</td>
<td>6.79</td>
<td>2.61</td>
<td>-4.56</td>
<td>3.67</td>
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<tr>
<td>Trailing 12M Gross Margin</td>
<td>32.14</td>
<td>33.16</td>
<td>34.17</td>
<td>34.13</td>
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<tr>
<td>Growth (YoY)</td>
<td>-4.72</td>
<td>3.18</td>
<td>3.03</td>
<td>-0.11</td>
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<tr>
<td>Trailing 12M Operating Margin</td>
<td>10.46</td>
<td>10.50</td>
<td>10.91</td>
<td>10.92</td>
<td></td>
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<tr>
<td>Growth (YoY)</td>
<td>-7.58</td>
<td>0.35</td>
<td>3.91</td>
<td>0.15</td>
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<tr>
<td>Trailing 12M R &amp; D Expenditures</td>
<td>6.15</td>
<td>6.86</td>
<td>7.82</td>
<td>7.89</td>
<td>25.26</td>
<td>26.78</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>21.71</td>
<td>22.23</td>
<td>22.19</td>
<td>23.28</td>
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<tr>
<td>Free Cash Flow/Basic Shr</td>
<td>21.96</td>
<td>24.57</td>
<td>29.56</td>
<td>29.67</td>
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## Fundamental Ratio Comparisons

### S&P Valuation

<table>
<thead>
<tr>
<th>Absolute Basis:</th>
<th>High</th>
<th>Low</th>
<th>Median</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/E</td>
<td>24.02</td>
<td>11.96</td>
<td>16.58</td>
<td>18.46</td>
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<tr>
<td>P/B</td>
<td>2.98</td>
<td>1.64</td>
<td>2.41</td>
<td>2.76</td>
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<tr>
<td>P/S</td>
<td>1.87</td>
<td>0.78</td>
<td>1.39</td>
<td>1.79</td>
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<tr>
<td>P/EBITDA</td>
<td>10.63</td>
<td>4.4</td>
<td>7.61</td>
<td>10.63</td>
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### Consumer Discretionary Valuation

<table>
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<th>Median</th>
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<tr>
<td>P/E</td>
<td>395.32</td>
<td>13.28</td>
<td>25.88</td>
<td>20.71</td>
</tr>
<tr>
<td>P/B</td>
<td>5.14</td>
<td>1.79</td>
<td>3.25</td>
<td>4.93</td>
</tr>
<tr>
<td>P/S</td>
<td>1.57</td>
<td>0.48</td>
<td>1.05</td>
<td>1.42</td>
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<tr>
<td>P/EBITDA</td>
<td>10.98</td>
<td>4.55</td>
<td>7.80</td>
<td>9.89</td>
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</table>
Price to Earnings

S&P 500 vs. Consumer Discretionary

Consumer Discretionary Industries
Price to Sales

S&P 500 vs. Consumer Discretionary

Consumer Discretionary Industries
Price to Book

S&P 500 vs. Consumer Discretionary

Consumer Discretionary Industries
Price to Cash Flow

S&P 500 vs. Consumer Discretionary

Consumer Discretionary Industries
Recommendation - UNDERWEIGHT

Major Positives

● Strong U.S. dollar (especially relative to the Euro)
  ○ Contractionary monetary policy in U.S. (versus expansionary in Europe)
  ○ Less foreign sales of U.S. goods and services

● Digital environment
  ○ E-commerce industry causing more competition
  ○ Hurting media companies

Biggest Risks

● Economy is strong- markets near all-time highs (expecting to contract)
  ○ More discretionary income

● Low oil prices- less money spent on gas
  ○ More money than usual to spend on goods and services within the sector
Which Industries to Over/Underweight?

Underweight

- Retail
  - Strong U.S. dollar
  - Growth of e-commerce industry
- Media
  - Too much reliance on TV/cable
  - Decreasing popularity of print media

Overweight

- Automobiles and Components
  - Low oil prices leading to higher sales for larger vehicles
Questions?