Consumer Discretionary Sector

*Student Investment Management*

**Team Members:**
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Ferny Angeles Paz

June 29th, 2016
Agenda

- Sector Overview
- Business Analysis
- Economic Analysis
- Financial Analysis
- Valuation Analysis
- Recommendation
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What is Consumer Discretionary Sector?

A sector of the economy that consists of businesses that sell nonessential goods and services. Companies in this sector include retailers, media companies, consumer services companies, consumer durables an apparel companies, and automobiles and components companies.

Information Technology 20.4%
Financials 16.3%
Health Care 14.7%
Consumer Discretionary 12.6%
Consumer Staples 10.1%
Industrials 10%
Energy 7.1%
Utilities 3.3%
Materials 2.8%
Telecommunication Services 2.7%

Based on GICS® sectors
The weightings for each sector of the index are rounded to the nearest tenth of a percent; therefore, the aggregate weights for the index may not equal 100%.
As Of May 31, 2016
Industries: 87 members and 5 industry groups

- Automobiles & Components (7 members)
- Consumer Durables & Apparel (20 members)
- Consumer Services (12 members)
- Media (15 members)
- Retailing (33 members)
Consumer Discretionary: Top Companies & market Cap

THE HOME DEPOT $159 Bn.

The Walt Disney Company $156 Bn.

COMCAST $153 Bn.

McDonald's $104 Bn.

NIKE $156 Bn.

STARBUCKS COFFEE $89.5 Bn.

LOWE'S $69 Bn.

Priceline Group $60 Bn.

Time Warner $55 Bn.

amazon $334 Bn.
Consumer Discretionary vs S&P 500

Overview

Economic

Financial

Valuation

Recommendation

SP5COND vs SP500 YTD

SP5COND vs SP500 QTD

S&P 500 (TR)

Consumer Discretionary Select Sector Index TR
Business Analysis
Business Cycles

- **Cyclical**
- **Outperforms market: during economic expansion/recovery**
- **Underperforms market: during recession/contraction**

- **Currently over performing S&P 500**
Currently outperforming S&P 500
Porter’s Five Forces Analysis

Degree of rivalry —High

Very high for retail, apparel and restaurant companies

Threat of New Entrants

- Advantage for established companies
- Large economies of scale
- Large capital requirements, large overhead costs
- New companies enter on more niche areas

Bargaining Power of Suppliers

- Varies by industry
- Impacted by unions, material availability and economy

Bargaining Power of Buyers

- Many alternatives (brick-and-mortar stores and online)
- Low degree of differentiation
- Very price sensitive

Threat of substitutes

- Low switching costs (low loyalty)
Economic Analysis
Factors influencing the consumer discretionary sector

The following factors could directly influence the performance of the consumer discretionary sector:

- Consumer Confidence
- CPI & Average Wage Rate
- Federal Funds Rate
- Oil Prices
- GDP
- Consumer Staples
- Unemployment Rate
- Exports

Source:
Consumer Discretionary spending is positively correlated with consumer confidence. Strong consumer confidence should coincide with consumer discretionary spending.
Consumer Discretionary spending is also has a positive relationship with consumer staples though it has been outperforming consumer staples since 2013.
Consumer discretionary is negatively correlated to unemployment rate. When unemployment decreases, consumer discretionary spending increases.
Consumer Discretionary vs Exports

Consumer discretionary improves when exports increase. However, fears of further US dollar appreciation against major currencies might make US exports expensive, thus causing decline in exports and consumer discretionary.
Consumer discretionary tends to be strong during period of economic expansion and weak during periods of economic contraction.
Consumer Discretionary vs Oil Prices

Consumer discretionary improves when oil prices are low. The dramatic decline of oil prices from over $100 to roughly $50/barrel have helped consumer discretionary spending increase.
Low interest rates are in favor of consumer discretionary sector. However, As interest rates have increased, consumers discretionary spending may start declining.
Minimal changes in CPI has allowed consumer discretionary spending to increase. However, If CPI starts to increase sharply, consumer discretionary spending would decline.
Continuous increases in average wage rate will positively affect consumer discretionary spending.
Financial Analysis

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### Sales Growth Rate (sector)

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>COND</td>
<td>-18.10%</td>
<td>2.52%</td>
<td>10.13%</td>
<td>6.04%</td>
<td>15.96%</td>
<td>5.81%</td>
<td>5.68%</td>
<td>3.74%</td>
<td>9.32%</td>
<td>5.54%</td>
</tr>
<tr>
<td>S&amp;P500</td>
<td>-9.04%</td>
<td>4.08%</td>
<td>8.67%</td>
<td>4.46%</td>
<td>2.96%</td>
<td>3.61%</td>
<td>-1.81%</td>
<td>0.02%</td>
<td>2.43%</td>
<td>6.15%</td>
</tr>
</tbody>
</table>
Sales Growth Rate (industry)
Profit Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>SPX: Profit Margin</th>
<th>COND</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>6.99%</td>
<td>3.87%</td>
</tr>
<tr>
<td>2004</td>
<td>7.25%</td>
<td>0.88%</td>
</tr>
<tr>
<td>2005</td>
<td>8.35%</td>
<td>2.25%</td>
</tr>
<tr>
<td>2006</td>
<td>9.39%</td>
<td>3.89%</td>
</tr>
<tr>
<td>2007</td>
<td>7.13%</td>
<td>1.04%</td>
</tr>
<tr>
<td>2008</td>
<td>2.41%</td>
<td>-4.01%</td>
</tr>
<tr>
<td>2009</td>
<td>6.28%</td>
<td>4.14%</td>
</tr>
<tr>
<td>2010</td>
<td>8.51%</td>
<td>6.21%</td>
</tr>
<tr>
<td>2011</td>
<td>8.88%</td>
<td>7.68%</td>
</tr>
<tr>
<td>2012</td>
<td>8.36%</td>
<td>6.51%</td>
</tr>
<tr>
<td>2013</td>
<td>9.62%</td>
<td>6.95%</td>
</tr>
<tr>
<td>2014</td>
<td>9.27%</td>
<td>7.14%</td>
</tr>
<tr>
<td>2015</td>
<td>8.11%</td>
<td>6.83%</td>
</tr>
<tr>
<td>2016</td>
<td>8.11%</td>
<td>7.20%</td>
</tr>
</tbody>
</table>

Source:
Operating Margin
R&D/ Sales Ratio

2010 | 1.61% | COND
2011 | 1.34% | COND
2012 | 1.61% | COND
2013 | 1.67% | COND
2014 | 1.77% | COND
2015 | 1.95% | COND

2010 | 2.45% | SPX
2011 | 2.38% | SPX
2012 | 2.47% | SPX
2013 | 2.60% | SPX
2014 | 2.71% | SPX
2015 | 3.03% | SPX
Valuation Analysis
## Multiples Valuation (10Y)

<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>26.84</td>
<td>13.62</td>
<td>19.38</td>
<td>19.37</td>
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<tr>
<td>P/B</td>
<td>5.17</td>
<td>1.88</td>
<td>3.59</td>
<td>4.8</td>
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<tr>
<td>P/S</td>
<td>1.6</td>
<td>0.63</td>
<td>1.22</td>
<td>1.45</td>
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<tr>
<td>P/EBITDA</td>
<td>12.33</td>
<td>6.82</td>
<td>9.25</td>
<td>10.66</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Relative to SP500</th>
<th>High</th>
<th>Low</th>
<th>Median</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/E</td>
<td>19.35</td>
<td>13.44</td>
<td>17.41</td>
<td>19.35</td>
</tr>
<tr>
<td>P/B</td>
<td>2.83</td>
<td>2.00</td>
<td>2.58</td>
<td>2.81</td>
</tr>
<tr>
<td>P/S</td>
<td>1.87</td>
<td>0.91</td>
<td>1.55</td>
<td>1.87</td>
</tr>
<tr>
<td>P/EBITDA</td>
<td>10.83</td>
<td>5.19</td>
<td>7.46</td>
<td>10.83</td>
</tr>
</tbody>
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Sector Relative to S&P 500 (2009 – 2018E)

Overview

Economic

Valuation

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Business

Recommendation
Recommendation
Recommendation

Outperforming the S&P 500

Improving job market

Wage growth

Overweight
The sector relative to the S&P 500
End of Presentation

Thank You For Listening 😊
References

Sector classification Retrieved from:  

YTD and QTD data Retrieved from:  
http://us.spindices.com/indices/equity/consumer-discretionary-select-sector-index

Slide 8/9. Retrieved from:  

All other data is obtained from Bloomberg