Consumer Discretionary Sector Analysis

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Consumer Discretionary: At A Glance
Overview

- Consumer Discretionary – “a sector of the economy that consists of businesses that sell nonessential goods and services. Companies in this sector includes retailers, media companies, consumer services companies, consumer durables and apparel companies, and automobiles and components companies.”
Size of Sector (As of September 30, 2015)

- S&P 500
  - 13.16%
  - 4.49 Trillion Market Cap (October 14th)

- OSU Portfolio
  - 12.88%

- Consumer Discretionary, 13.16%
- Consumer Staples, 9.90%
- Energy, 7.09%
- Financials, 16.28%
- Health Care, 14.87%
- Industrials, 9.99%
- Info. Tech, 20.37%
- Materials, 2.87%
- Telecom, 2.37%
- Utilities, 3.10%

- Consumer Discretionary, 13.28%
- Consumer Staples, 10.01%
- Energy, 6.51%
- Financials, 15.99%
- Health Care, 13.28%
- Industrials, 9.83%
- Info. Tech, 20.61%
- Materials, 2.77%
- Other/Cash, 3.47%
- Telecom, 2.33%
- Utilities, 2.30%

Other/Cash, 3.47%
Largest Companies (Market Cap)
Historically, sector's lowest point was in early 2009. The correction, as seen at the end of 2015, did not greatly harm the general upward trend of the sector.
Performance (Year To Date)

*Major dip seen in August (correction), but also at end of September (historically volatile/low performance month).*
Business Analysis
Business Cycle

- Over-performs market during times of economic growth/security.
- Underperforms market during recessions, corrections, etc.
- Cyclical Nature
- Currently outperforming S&P 500
Influences

- Sector is highly cyclical, due to the nature of the type of stocks that compose this sector (luxury goods, etc).
- Economy - when doing well, people have more to spend on non-necessities.
- Unemployment Level
- Job Market
- Consumer Confidence
- Supply/Demand
## Porter’s Five Forces

<table>
<thead>
<tr>
<th>Threat of New Entrants (Medium)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Varies greatly by industry.</td>
</tr>
<tr>
<td>• Large economies of scale.</td>
</tr>
<tr>
<td>• Large capital requirements</td>
</tr>
<tr>
<td>• Highly competitive industries</td>
</tr>
<tr>
<td>• Potential niche markets</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Threat of Substitutes (High)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Varies slightly by industry</td>
</tr>
<tr>
<td>• People can choose not to spend – these goods/services are not necessities. Can wait to buy a new car or purchase non-designer purse.</td>
</tr>
<tr>
<td>• Competitive industries – many options and alternatives</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bargaining Power of Buyers (High)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Buyers can go elsewhere/buy from different companies</td>
</tr>
<tr>
<td>• Many alternatives</td>
</tr>
<tr>
<td>• Low switching costs, low loyalty (in many industries)</td>
</tr>
<tr>
<td>• Very price sensitive industry</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bargaining Power of Suppliers (Medium)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Depends on industry</td>
</tr>
<tr>
<td>• May be impacted by unions, material availability, and economy</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rivalry (High)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Many competitors in these industries, and all are competing for a specific market</td>
</tr>
<tr>
<td>• Some markets/customer segments are very small</td>
</tr>
<tr>
<td>• Larger companies have advantages in terms of market share, economies of scale, and deeper pockets</td>
</tr>
</tbody>
</table>
Economic Analysis
The Consumer Discretionary sector can be heavily influenced by the following economic factors:

- Domestic and global economies
- Consumer confidence
- Employment
- Personal income (wage growth)
- Exchange rates
- Inflation rate
- Commodity price volatility (e.g. gas prices)
- Interest rates
- Imports and exports
Consumer Discretionary and Consumer Confidence

Consumer Discretionary spending has a strong correlation with consumer confidence. Strong consumer confidence should coincide with consumer discretionary spending.
Consumer Discretionary spending mirrors Consumer Staples but it has been growing at a premium.
Consumer Discretionary spending has an inverse relationship with the unemployment rate. If the unemployment rate continues to fall consumer discretionary spending will benefit.
Consumer Discretionary and US Exports

Consumer Discretionary tends to expand when exports are strong. It appears the recent strength of the dollar has slowed US exports.
Consumer Discretionary and US GDP Growth

Consumer Discretionary spending is strong during expansion periods and weak during periods of contraction.
Consumer Discretionary spending is strong when oil/gas prices are low. Recent drops in oil prices have helped consumer discretionary spending surge.
Consumer Discretionary and Global GDP Growth

Consumer Discretionary spending is strong during expansion periods and weak during periods of contraction.
Consumer Discretionary spending has benefited from low interest rates. As the Fed raises rates consumer discretionary spending may slow.
Minimal changes in CPI has allowed Consumer Discretionary spending to expand.
Consumer Discretionary spending should increase as average wage grows. However, the relatively slow average wage growth over the past 6-years has not slowed consumer discretionary spending.
Recent market volatility has been driven by:

- Global deflationary pressures
- China’s slowing growth and policy struggles
- Uncertainty of the timing and severity Fed’s monetary policy

The US economy is largely driven by domestic consumption which has fueled the recent growth in the consumer discretionary sector.
Financial Analysis
COND vs S&P 500
Revenue Growth
## Revenue Growth vs S&P500

<table>
<thead>
<tr>
<th></th>
<th>COND</th>
<th>% Change</th>
<th>S&amp;P500</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>271</td>
<td>5.93</td>
<td>939</td>
<td>10.32</td>
</tr>
<tr>
<td>2011</td>
<td>298</td>
<td>6.27</td>
<td>1020</td>
<td>8.63</td>
</tr>
<tr>
<td>2012</td>
<td>316</td>
<td>6.04</td>
<td>1066</td>
<td>4.51</td>
</tr>
<tr>
<td>2013</td>
<td>367</td>
<td>16.14</td>
<td>1097</td>
<td>2.91</td>
</tr>
<tr>
<td>2014</td>
<td>389</td>
<td>5.99</td>
<td>1143</td>
<td>4.19</td>
</tr>
<tr>
<td>Current</td>
<td>401</td>
<td>3.08</td>
<td>1135</td>
<td>0.69</td>
</tr>
<tr>
<td>2015 EST</td>
<td>412</td>
<td>2.74</td>
<td>1132</td>
<td>0.26</td>
</tr>
<tr>
<td>2016 EST</td>
<td>437</td>
<td>6.07</td>
<td>1191</td>
<td>5.21</td>
</tr>
</tbody>
</table>
Gross Margin as a Sector

Gross Margin

- 2008: 25.9
- 2009: 32
- 2010: 32.98
- 2011: 32.92
- 2012: 33.73
- 2013: 32.13
- 2014: 32.87
- Current: 33.42
Profit Margin

COND Profit Margin tends to follow cyclically with the S&P
Profit Margin by industry (%)
The ROE for COND has outperformed the S&P as a whole, and is expected to grow slightly in the future.
R&D Expense

R&D has grown dramatically as retailers (top) and Big Auto (bottom) innovate to new markets.
FCF (millions)

Upward trend with growth of big retailers and media, low expense
Retail giants like Amazon
Valuation Analysis
## Fundamental Ratio Comparisons

### S&P 500 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>23.9961</td>
<td>11.9545</td>
<td>16.599</td>
<td>16.9229</td>
</tr>
<tr>
<td>P/B</td>
<td>2.8656</td>
<td>1.4848</td>
<td>2.2828</td>
<td>2.4905</td>
</tr>
<tr>
<td>P/S</td>
<td>1.8669</td>
<td>.7772</td>
<td>1.3127</td>
<td>1.6897</td>
</tr>
<tr>
<td>P/EBITDA</td>
<td>10.3165</td>
<td>4.4033</td>
<td>7.8</td>
<td>7.6</td>
</tr>
</tbody>
</table>

### COND 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>22.5716</td>
<td>13.619</td>
<td>18.9027</td>
<td>20.882</td>
</tr>
<tr>
<td>P/B</td>
<td>5.118</td>
<td>2.5098</td>
<td>3.7974</td>
<td>4.6672</td>
</tr>
<tr>
<td>P/S</td>
<td>1.5983</td>
<td>.9286</td>
<td>1.2764</td>
<td>1.4783</td>
</tr>
<tr>
<td>P/EBITDA</td>
<td>12.3306</td>
<td>7.2859</td>
<td>9.6365</td>
<td>11.1593</td>
</tr>
</tbody>
</table>
Price to Earnings

S&P vs COND

COND Industries
Price to Sales

S&P vs COND

COND industries
Price to Book

S&P vs COND

COND Industries
Price to Cash Flow

S&P vs COND

COND Industries
Recommendation
We should go slightly more underweight – down to 12.5%.

Due to the current business cycle being in the mid-to-late stages, the sector will not perform as well as it has in the past.
Sources/Research

- Slide 4: Investopedia, Consumer Discretionary
  http://www.investopedia.com/terms/c/consumer-discretionary.asp
- Slide 5: SIM Portfolio Appraisal Sept 2015 and Fidelity
- Slide 6-8, 15-24: Bloomberg Information/Charts
- Slide 11: Fidelity charts
Sources (Con’t)

- Slide 25: Chart from Fidelity site.
- All information/charts/graphs in the Financial Analysis and Valuation sections came from Bloomberg.