

# Consumer Discretionary



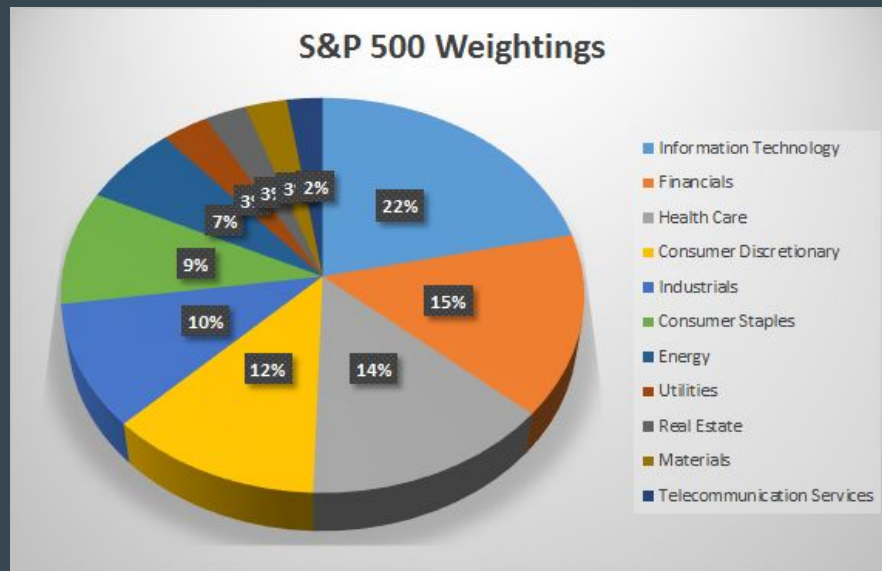
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# Agenda

- Overview
- Business Analysis
- Economic Analysis
- Financial Analysis
- Valuation Analysis
- Recommendation

# Overview

- Consumer Discretionary is a sector that consists of businesses that sell nonessential goods and services. Companies in this sector include automakers, consumer retailers, apparel companies and entertainment companies.
- Sector Market Cap: \$4.72 trillion
- 12.07% of the S&P 500
- 87 companies of the S&P 500



# Cons. Disc. Industries and Largest Companies

- Retailers
- Media Companies
- Consumer Services
- Consumer Durables and Apparel
- Entertainment and Leisure
- Automobiles and Components



407 B



180 B



179 B



177 B



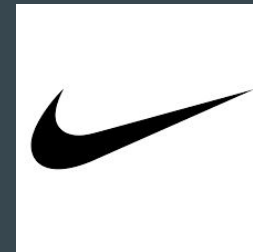
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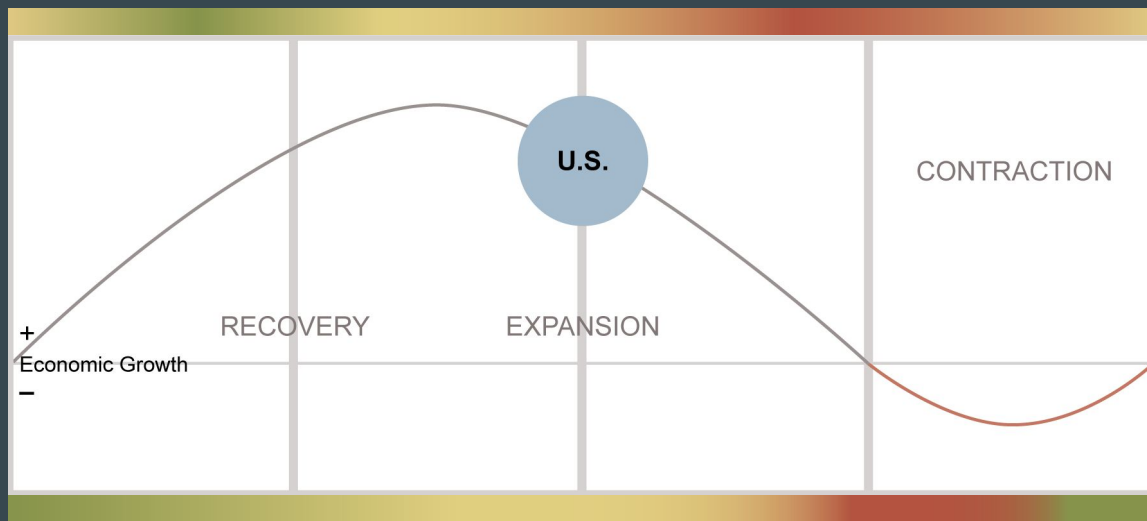
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# Business Cycle

- Overperform during strong economic growth
- Underperform during the end of economic expansion

## Characteristics of Late Stage Expansion

- Growth moderate
- Credit tightens
- Earnings under pressure
- Policy contractionary
- Inventories grow
- Sales growth falls



# Influences on Consumer Discretionary

## Positive Influences

- Consumer Confidence
- Unemployment Levels

## Negative Influences

- Weakness in retail
- Cyclical sector in tail end of expansion



# Porter's Five Forces

## Threat of New Entrants - Medium

- Substantial economies of scale
- High capital requirements and overhead costs

## Bargaining Power of Suppliers - Low

- Varies based on industry
- Impacted by unions, material availability

## Degree of Rivalry - High

- Intense competitive pressure
- Firm size matters - big players have power

## Bargaining Power of Buyers - High

- Many options available
- Low loyalty
- High price sensitivity

## Threat of Substitutes - High

- Discretionary spending - consumers can wait
- Low switching costs

# Economic Analysis

## Main Factors Driving Consumer Discretionary

1. Consumer Price Index
2. Consumer Sentiment
3. Interest Rate
4. Unemployment Rate

- **NEUTRAL Outlook on Sector**



# Economic Analysis

Factor 1: Consumer Price Index (CPI)

-The all items index rose 2.7% for the 12 months ending February.

-The index for all items less food and energy rose **2.2%** over the last 12 months

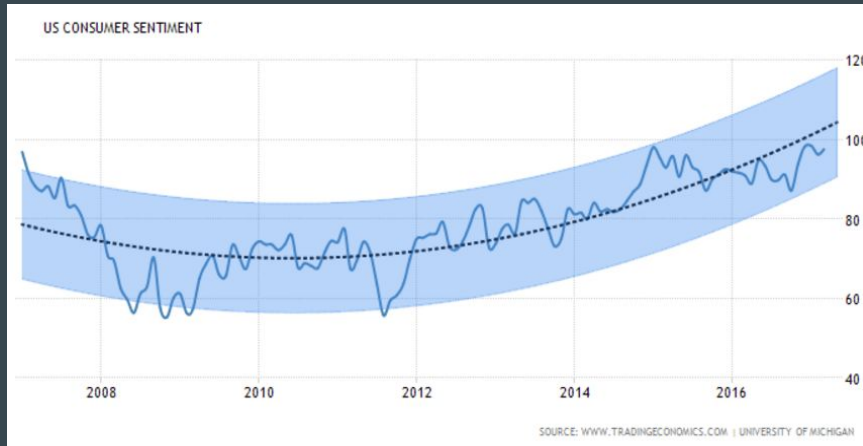
-15th straight month the 12-month change remained in the range of 2.1 to 2.3%

# Economic Analysis

Factor 2: US Consumer Sentiment:

-Last 97.6 and Q1/17 expected to be 95.5

-Expected to Decline to 92 by Q4/17 and trend towards 87 by 2020.



# Economic Analysis

## Factor 3: Interest Rates

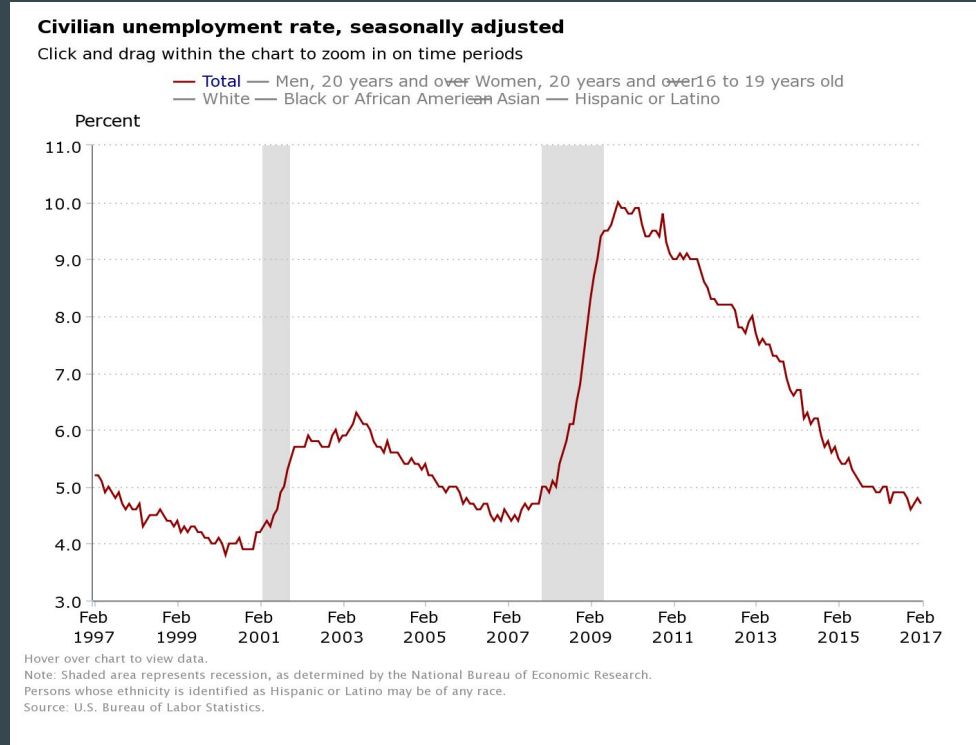
-Faster-than-expected rate hikes could hurt automobile and other large luxury purchases often made with credit.

# Economic Analysis

## Factor 4: Unemployment Rate

-Currently 4.7%

-Trending towards 5% in 2020



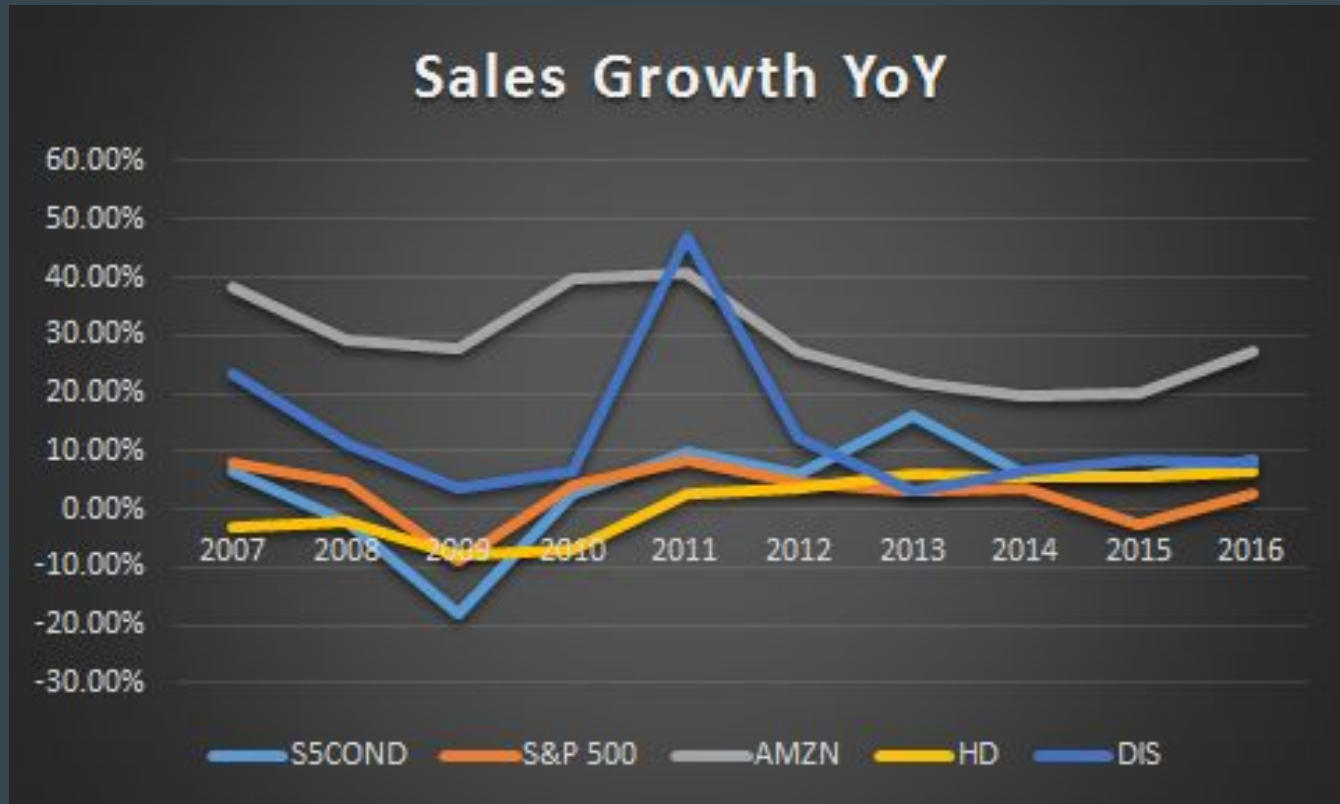
# Financial Analysis

Sales Growth, Profit Margin, PE, Fundamentals

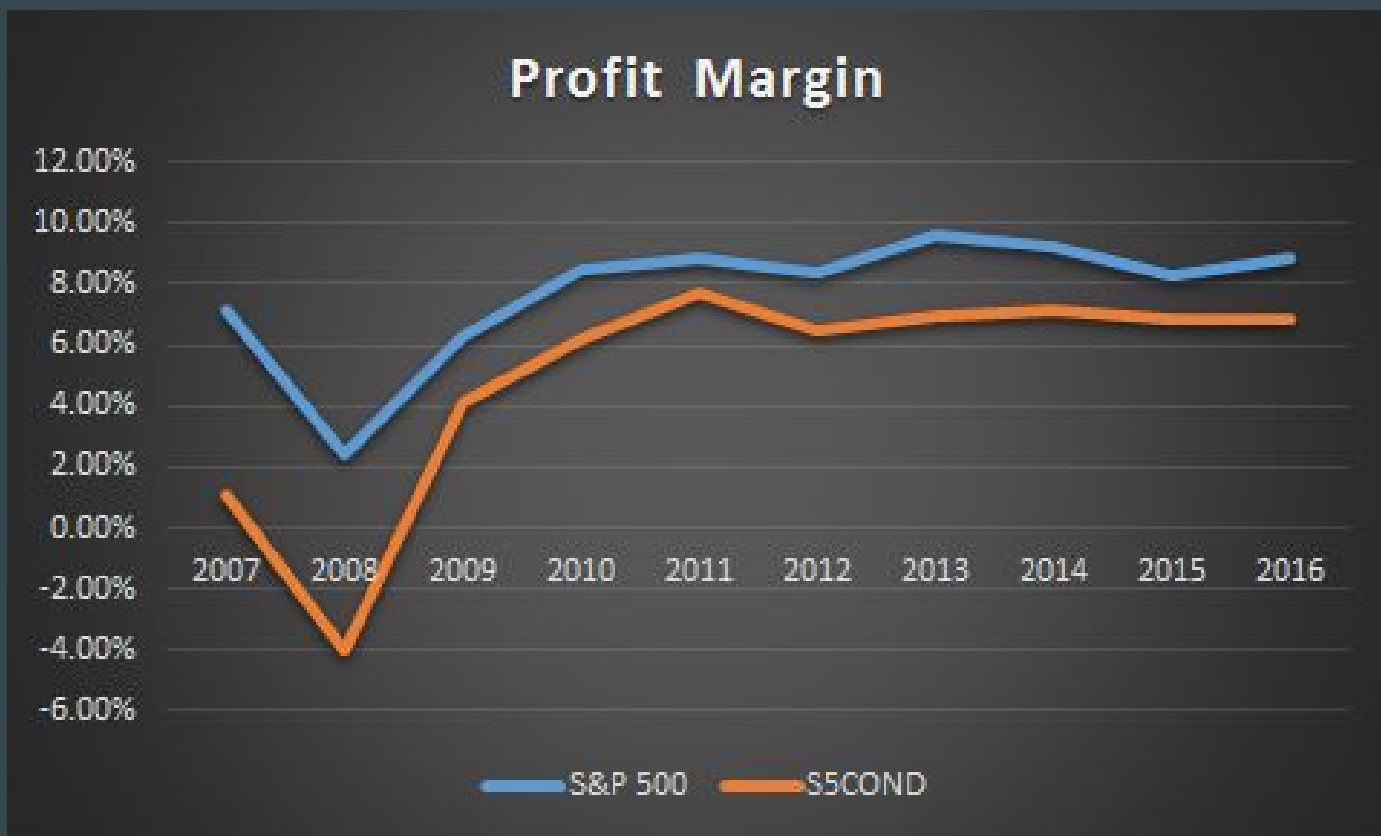
# Sales Growth Rate



# Sales Growth Rate (Key Companies)

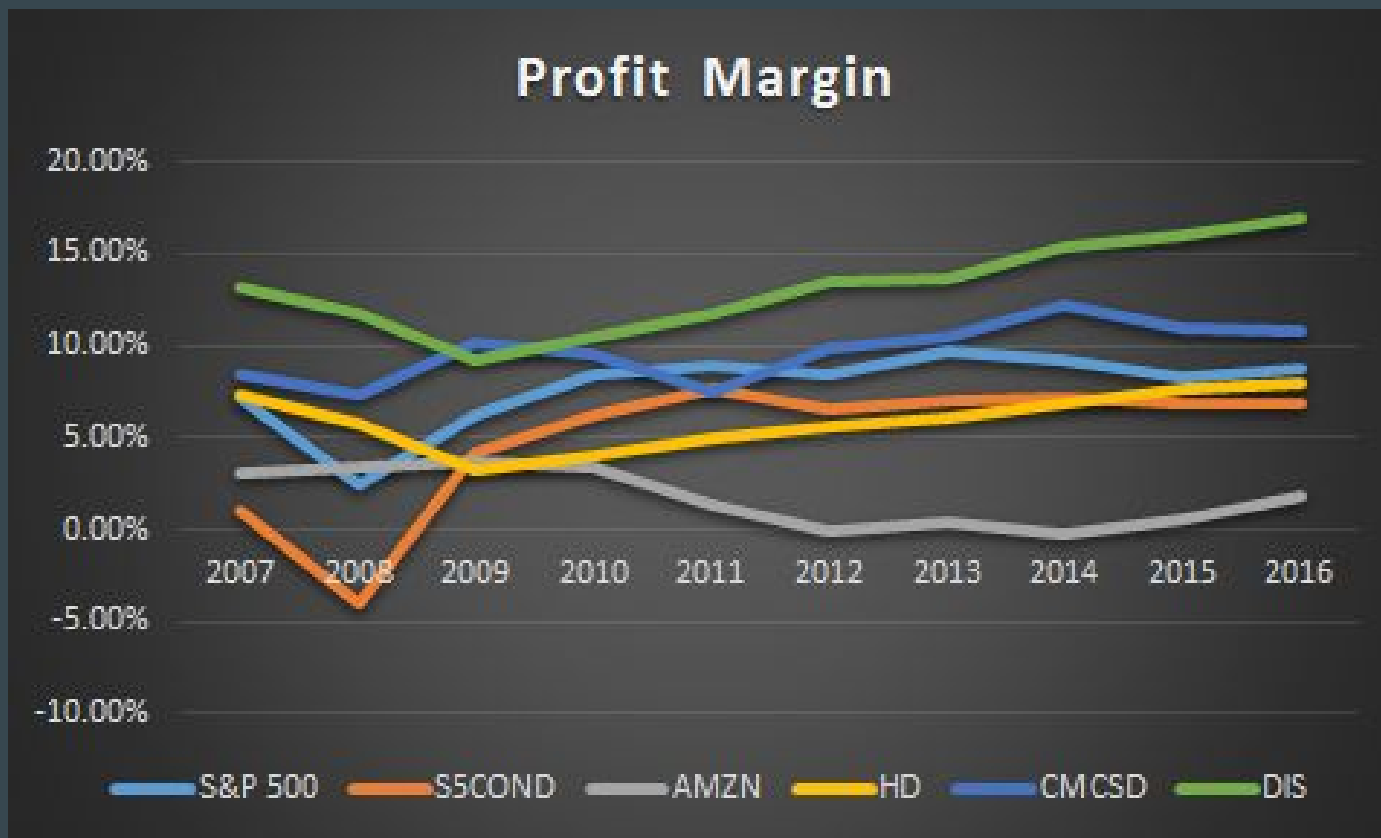


# Profit Margin





# Profit Margin (Key Companies)



# Operating Margin



# Fundamentals

## R&D (Percentage of Sales)



## ROE



## EPS



## FCF (Percentage Revenue)



# Multiples Valuation (10Y)

Absolute Basis	High	Low	Median	Current
P/E	42.45	13.28	19.41	20.10
P/B	4.83	1.89	3.44	4.31
P/S	1.49	0.53	1.16	1.45
P/EBITDA	10.06	5.79	7.72	9.88

Relative to SP500	High	Low	Median	Current
P/E	25.40	0.93	1.47	0.95
P/B	1.83	0.78	1.33	1.63
P/S	0.90	0.51	0.74	0.77
P/EBITDA	1.24	0.85	1.02	0.87

# Consumer Discretionary Relative to S&P 500 (2005-2016)

P/E



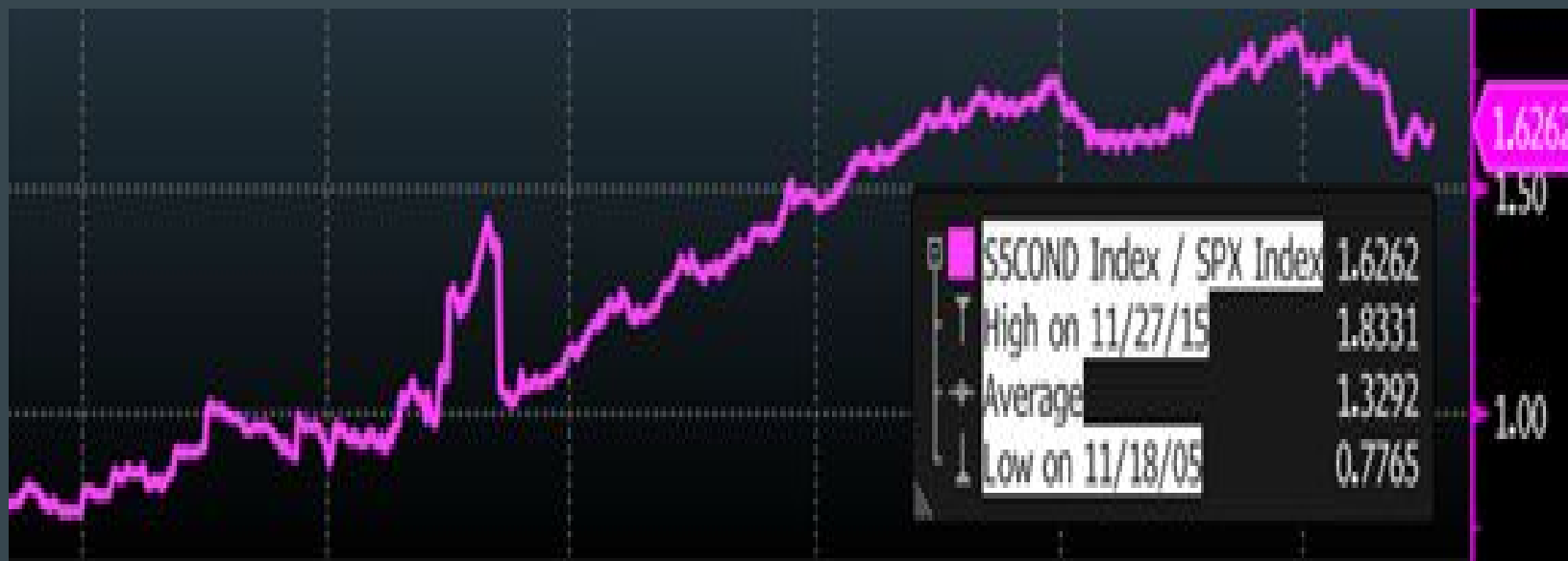
# Consumer Discretionary Industries

P/E



# Consumer Discretionary Relative to S&P 500 (2005-2016)

P/B



# Consumer Discretionary Industries

P/B





# Consumer Discretionary Relative to S&P 500 (2005-2016)

P/S



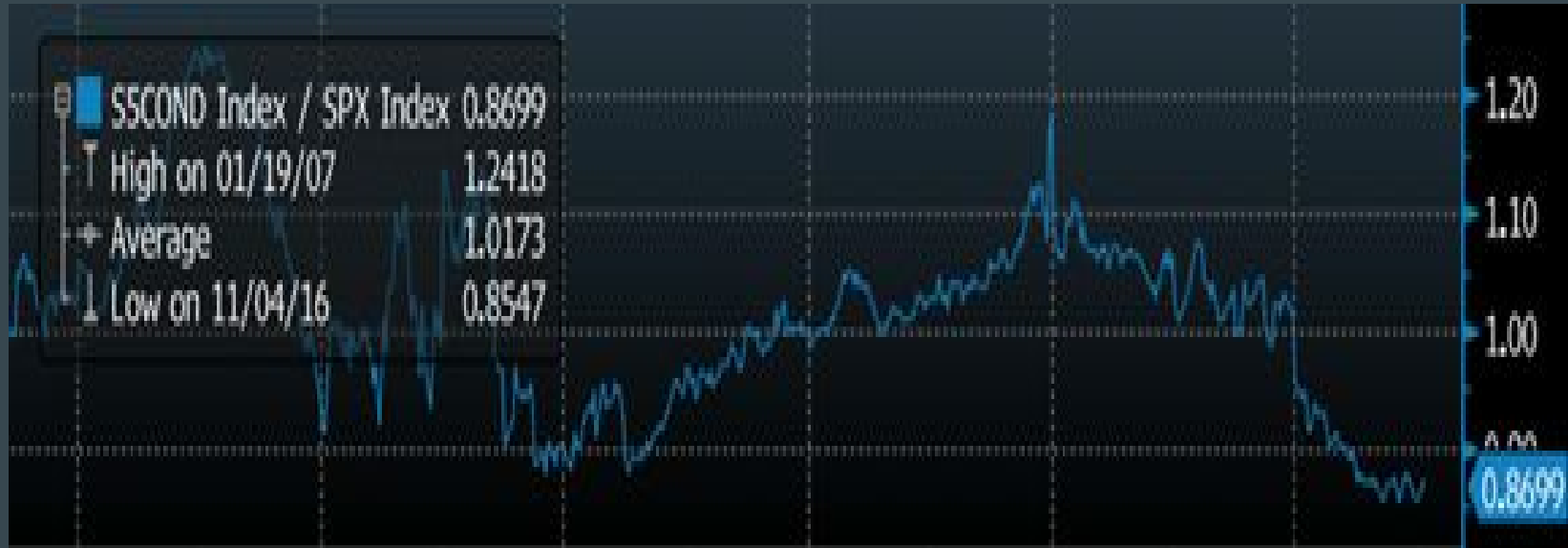
# Consumer Discretionary Industries

P/S



# Consumer Discretionary Relative to S&P 500 (2005-2016)

P/EBITDA



# Consumer Discretionary Industries

P/EBITDA



# Recommendation

- Slightly underweight relative to S&P 500
- Major positives:
  - End of economic expansion
  - Brick & Mortar retail is dying
- Biggest risks:
  - Expecting market down turn too quickly
  - Trump tax cuts turn out better than expected
  - Rate hikes further delayed

# Recommendation

- Industries to overweight:
  - Media Companies
  - Online Retailers
- Industries to underweight:
  - Retail
  - Entertainment and Leisure