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

![Amazon](amazon.png) - Revenue: 407 B
![The Home Depot](homedepot.png) - Revenue: 180 B
![Comcast](comcast.png) - Revenue: 179 B
![Disney](disney.png) - Revenue: 177 B
![McDonald's](mcdonalds.png) - Revenue: 105 B
![Priceline](priceline.png) - Revenue: 87 B
![Starbucks](starbucks.png) - Revenue: 79 B
![Nike](nike.png) - Revenue: 76 B
![Spectrum](spectrum.png) - Revenue: 76 B
**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

<table>
<thead>
<tr>
<th>Force</th>
<th>Description</th>
</tr>
</thead>
</table>
| 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 YoY

- 2007
- 2008
- 2009
- 2010
- 2011
- 2012
- 2013
- 2014
- 2015
- 2016

- 20.00%
- 15.00%
- 10.00%
- 5.00%
- 0.00%
- -5.00%
- -10.00%
- -15.00%
- -20.00%

S5COND  S&P 500
Sales Growth Rate (Key Companies)
Profit Margin (Key Companies)
Operating Margin

![Operating Margin Graph](image-url)
Fundamentals

- **R&D (Percentage of Sales)**
- **ROE**
- **EPS**
- **FCF (Percentage Revenue)**
## Multiples Valuation (10Y)

<table>
<thead>
<tr>
<th>Absolute Basis</th>
<th>High</th>
<th>Low</th>
<th>Median</th>
<th>Current</th>
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</thead>
<tbody>
<tr>
<td>P/E</td>
<td>42.45</td>
<td>13.28</td>
<td>19.41</td>
<td>20.10</td>
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<tr>
<td>P/B</td>
<td>4.83</td>
<td>1.89</td>
<td>3.44</td>
<td>4.31</td>
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<tr>
<td>P/S</td>
<td>1.49</td>
<td>0.53</td>
<td>1.16</td>
<td>1.45</td>
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<tr>
<td>P/EBITDA</td>
<td>10.06</td>
<td>5.79</td>
<td>7.72</td>
<td>9.88</td>
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</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>25.40</td>
<td>0.93</td>
<td>1.47</td>
<td>0.95</td>
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<tr>
<td>P/B</td>
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<td>0.78</td>
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<td>1.63</td>
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<tr>
<td>P/S</td>
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<td>0.74</td>
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<tr>
<td>P/EBITDA</td>
<td>1.24</td>
<td>0.85</td>
<td>1.02</td>
<td>0.87</td>
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</tbody>
</table>
Consumer Discretionary Relative to S&P 500 (2005-2016)
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)
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