

Analyst Q & A: Sector Spotlight on E-commerce



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Q *E-commerce has grown so much. Are there still opportunities for new investors?*

A Although e-commerce has experienced enormous growth over the past decade, it still appears to be early innings with over 90% of retail sales still transacted off line. As we approach this year's holiday season, e-commerce looks positioned to continue to lead retail spending as consumers enjoy the price transparency, value and convenience of shopping online. In the long term, the sector appears positioned to grow share suggesting that the best days for the industry could still lie ahead.

Q *Why does e-commerce seem to be accelerating so quickly?*

A It's all about the intersection of demographics and technology. The rise of the millennial generation—a generation that almost seems to have been born with smartphone in hand—has been a factor in the acceleration of e-commerce. This has occurred in concert with growth in wireless infrastructure and improvements in smartphone capabilities that have facilitated the growth of shopping online. With 5G mobile network deployment expected in coming years, supporting much higher data throughput capabilities, e-commerce opportunities appear poised to further evolve across all facets of daily life.

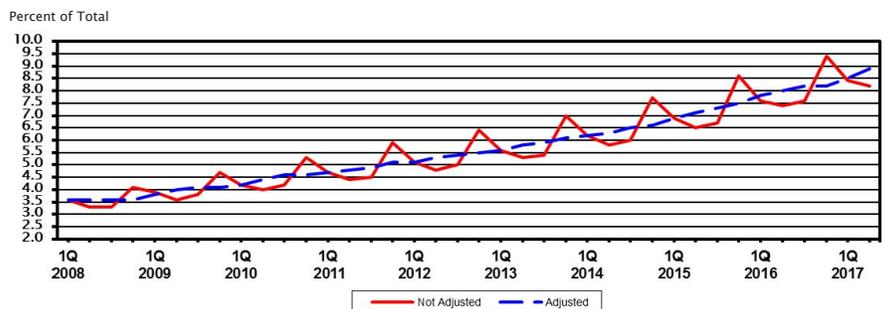
Q *Does the growth of e-commerce mean all traditional retailers are going the way of the dinosaur?*

A Absolutely not. Sure, there will be some losers that have difficulty responding to what has been called “the Amazon effect,” particularly among companies that find the rapidly shifting industry dynamics difficult to navigate. However, there are a few key points to think about: This is not a new phenomenon and most, if not all, retailers have implemented steps to move transactions online. Furthermore, some categories are less accommodating to e-commerce solutions and will likely never experience high e-commerce penetration.

We think particularly defensible categories may be found in big box retailers and dollar stores, with department stores most vulnerable. Among specialty retailers, we see winners in those companies that successfully implement a hybrid approach, adopting e-commerce omnichannel strategies that leverage retail strengths, as well as those that follow a treasure hunt merchandising strategy. The bottom line is that we see opportunity in the sector particularly among companies where the threat from the Amazon effect may be less than feared.

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Estimated Quarterly U.S. Retail E-commerce Sales as a Percent of Total
(1st Quarter 2008-2nd Quarter 2017)



Source: U.S. Census Monthly and Annual Retail Trade;
https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

Q *What effect has e-commerce had on grocery stores?*

A There has been a recent push from e-commerce companies, big box retailers and grocery stores to introduce e-commerce solutions across the grocery sector. There have been obstacles to online grocery growth in the past linked to supply chain concerns and consumer shopping preferences. From a supply chain side, fresh product, in particular, does not lend itself very well to e-commerce solutions given handling requirements and consumer desire to individually pick certain items. However, the price, convenience and immediacy provided by same-day delivery may be resonating with shoppers. The bottom line is that it's very early and the winners and the losers are still being sorted out.

Q *How is the rest of the world impacted in contrast to the U.S.?*

A In some ways the future of e-commerce globally may be even more exciting than in the U.S. We see some emerging economies that lack retail brick-and-mortar infrastructure leapfrogging into e-commerce as this channel can provide consumers access to needed products immediately. The U.N. Telecommunication Development Sector reports that about 70% of the world's youth are now on the internet and that, of the 803 million global youth internet users, 320 million are in China and India. Consumers globally are embracing e-commerce solutions and are transforming global commerce at a rapid pace, which may accelerate with further expansion of mobile broadband across developed and lesser-developed economies.

Q *Are there headwinds that could derail e-commerce growth?*

A Although the long-term outlook appears quite encouraging for the secular growth of e-commerce, a key concern of consumers engaging in online transactions is cybersecurity and privacy. Despite years of effort across the industry to safeguard consumer data, data breaches seem to be occurring more frequently, which, at times, has impacted many millions of consumers. These data breaches can fuel distrust and, if a tipping point were reached, could influence some consumers to avoid participating in e-commerce.

Q *Where are the best opportunities to invest in e-commerce?*

A With the adoption of e-commerce across industries, it is no longer as simple as just picking among pure e-commerce companies for exposure to the sector. Now, we see retailers and manufacturers adopting integrated direct-to-consumer e-commerce strategies that are playing an increasingly important part of growth models. Therefore, we think it makes sense to look from the bottom up, both domestically and internationally, at companies embracing e-commerce strategies to drive growth. Although the most direct investment vehicle remains the pure play e-commerce companies, we see emerging opportunities among both retailers and consumer goods manufacturers that are growing their e-commerce platforms.

If you have questions about any of the topics covered in this handout, please contact your Davenport Investment Executive or call (800) 846-6666.

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