



SECTOR RETAIL

Grappling with a giant

The hype surrounding the arrival of Amazon could be an opportunity for investors

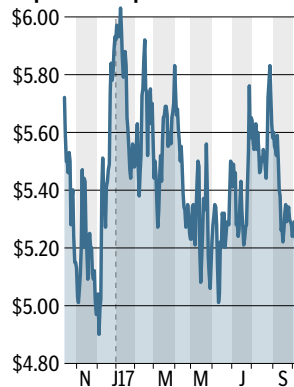
With the launch of Amazon in Australia rumoured to be happening this month, it's worth returning to the retail sector to understand whether the decimation of market capitalisations represents an overreaction and therefore an opportunity.

Estimates for Amazon Australia's annual revenue range from \$3 billion to \$15 billion but even at \$15 billion it would represent no more than 5% of total retail spending of about \$312 billion. Take out Amazon's \$15 billion estimate, along with about \$75 billion for Coles and Woolworths supermarkets, and there is still about \$220 billion of revenue for retailers, suggesting they aren't all at imminent risk of extinction.

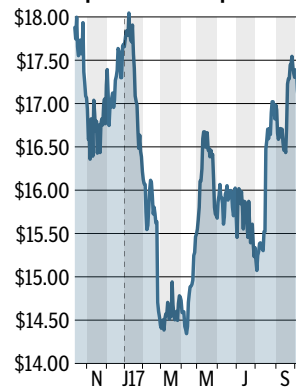
While sales made at low prices still generate revenue, profit margins can be negatively impacted. Amazon's arrival may do more to impact survivorship through pressure on prices than it will through capturing market share.

Another interesting dilemma for retail businesses, and their long-term investors,

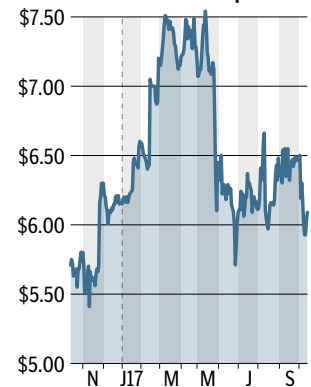
Bapcor share price



ARB Corporation share price



Nick Scali Limited share price



arises when one contemplates how leading brands might be forced to respond if their traditional distribution network of independent bricks-and-mortar stores become less viable. Currently large brands pay up to 50% of their margins to a retail store network to distribute their product. Amazon is offering to do the same online for 15%. It seems an obvious choice for the brands but remember what's happened to brands that

allowed the large supermarkets to control too much of their distribution.

With the list of US retailers falling into Chapter 11 bankruptcy growing by the day, can any Australian retailers survive Amazon's assault on sales and margins?

Roger Montgomery is the founder and CIO at the Montgomery Fund. For his book, Value.able, see rogermontgomery.com.

1 Bapcor

Listed in 2014, three years after being bought by private equity, Bapcor owns the Burson Auto Parts, Autopro, Autobarn and Opposite Lock 4WD aftermarket autoparts networks and brands, among others, which is a category that Amazon has not entered.

Organically and through acquisitions, BAP's profits have increased from \$23 million in 2015 to an estimated \$86 million in the 2018 financial year. Rising debt and an expensive share price as well as the rise of electric vehicles with fewer parts are turn-offs but Bapcor at the right price has investment merit.

ASX code BAP

Price \$5.51
52wk ▲ \$6.08
52wk ▼ \$4.83
Mkt cap \$1.54bn
Dividend 13¢
Dividend yield 2.4%
PE ratio 23

HOLD

2 ARB Corporation

Amazon's logistics prowess does not extend to heavy items such as 4WD winches, snorkels, canopies and bullbars – all staples for ARB. And the advent of an autonomous recreational vehicle may be some decades away.

The company's brand enjoys a strong reputation in Australia, which provides more than 80% of revenue, and it is expanding globally with 13% of revenue now stemming from the US. With profits up 2½ times in the past decade, and no debt, only an expensive share price prevents this company being a buy.

ASX code ARB

Price \$17.38
52wk ▲ \$18.27
52wk ▼ \$14.28
Mkt cap \$1.47bn
Dividend 34¢
Dividend yield 2%
PE ratio 29

HOLD

3 Nick Scali Ltd

At \$37 million, 2017 profit from selling upmarket furniture was six times higher than it was just 10 years earlier. Importantly, the company has achieved this growth with only a marginal increase in debt and not a single additional dollar raised from shareholders. Returns

on equity have increased from about 40% in 2008 to almost 53% in 2017. In other words, the company has become more profitable as it has increased in size. This is a rare quality. However, growth has coincided with an apartment boom and it currently remains the wrong time of the cycle to be aggressively buying.

ASX code NC

Price \$6.24
52wk ▲ \$7.60
52wk ▼ \$5.35
Mkt cap \$505m
Dividend 34¢
Dividend yield 5.4%
PE ratio 13.57

HOLD

Prices as at close of business, 13-Oct-17. Charts as at close of business, 12-Oct-17.