SECTOR RETAIL

Sales of the new century

Traditional stores will struggle as price-conscious shoppers flock to online platforms

To better understand retailing's future it is important to examine its development to date and to look at countries where its future is already being embraced, such as South Korea and China.

The rate of growth of online retail is well above that of offline retailing and the result is a loss of market share for those brick-and-mortar retailers not online. The end result is a loss of revenue and profit, which caused many retailers to collapse in 2017.

The online growth, of course, is not being entirely driven by retailers themselves. One example of the changes being faced by retailers is the ability of mobile technology to remove borders for consumers. Another is the growth of large online retailers, which has improved the economics for logistics companies, and this has translated into efficiencies for small retailers, enabling them to compete more effectively and proliferate. Improvements in living standards, a burgeoning number of brands and rapid changes and uptake in technology have driven changes in consumer preferences. The convenience of online shopping has also allowed consumers to dedicate more time to entertainment, travel, eating out and even working.

Another obvious development is the change in the value and perception of advertising. Consumers trust what a brand says about themselves less than what other shoppers have to say. Social media have therefore usurped the traditional channels for retailers to articulate their messages.

According to various outlets, ecommerce penetration is highest in the Asia-Pacific region. But this does not include the more mature markets of Japan, Hong Kong, Singapore and Australia. To date, however, these countries haven't had the benefit of legislation that supports the growth of digital payment methods, and nor have they welcomed Amazon (or not until recently in the case of Australia).

The history of retailing is a lesson in change rather than disruption. In each country or region modern retailing has commenced with street-level shops run by mums and dads and/or markets. Strip shopping developed next and the foot traffic it generated attracted the formation of department stores and supermarkets, which concentrated foot traffic even more. Around this foot traffic formed shopping centres or malls and that allowed the rapid growth of specialty chains.

The development of mega malls and concept stores was a smaller evolutionary step interrupted by the arrival of ecommerce and omni-channel retailing. It is likely that continuing advances in ecommerce technology will bring further cost advantages, and with that the future of ecommerce retailing will see the simultaneous development of mega online retailers such as Amazon and millions of smaller competitors.

> **The next stage will be the rise of the premium online retailer and the eselling of perishables**

Online retailing itself will evolve too. Initially, consumers purchased commodity-like products, such as books, stationery and electronics, that were simply cheaper online. The shift to purchasing online was driven by price. This, of course, affected smaller specialty stores.

As the range of offerings exploded online, department stores began to struggle and we can see this in Australia with the difficult trading conditions experienced by Myer and David Jones. As the strength of the largest online retailers grew, so did their buying power. The development of generic branded products across a range of categories ensued, with more pressure heaped on traditional brands. This is perhaps most obvious in countries such as Korea, where platforms like Gmarket and 11Street cater to brand-agnostic, cost-conscious buyers, and where a pair of Slazenger runners costs less than $10.

At this juncture, in categories such as fashion, traditional brands lose share and department stores experience falling foot traffic. We have seen lower same-store sales growth for many retailers, from Foot Locker to Prada, and departments stores dependent on fashion for foot traffic have experienced declining comparisons.

The next stage will be the rise of the premium online retailer and the eselling of perishables and bulkier items. This will occur once ecommerce is able to establish trust and is likely to coincide with a slowing of online volume growth.

Retailers will be forced to increase their average selling prices to combat flat volumes and increasing churn. Any remaining compelling reason to shop at a department store will then disappear.

Roger Montgomery is the founder and CIO at the Montgomery Fund. For his book, Value.Able, *see rogermontgomery.com. The Montgomery Global Funds own shares in Amazon and Prada.*

Prices as at close of business, 15-Jan-18. Charts as at close of business 11-Jan-18.

1 JB Hi-Fi

ASX code JBH
Price $28.18
52wk ▲ $30.78
52wk ▼ $21.20
Mkt cap $3.2bn
Dividend $1.18
Dividend yield 4.2%
PE ratio 18.26
HOLD

The arrival of Amazon was well flagged and JB Hi-Fi had plenty of time to prepare. The company has made some changes to its supply network and online offering.

The Reserve Bank has said that consumer confidence is improving and that wage growth will remain muted, ensuring margins should be maintained for better-quality retailers.

In the short term, lacklustre iPhone 8 sales were due to the delayed release of the iPhone X, which did have an impact on traffic initially, but gaming hardware releases such as Nintendo Switch and Microsoft's Xbox One X console should help to support like-for-like or same-store sales growth.

The longer-term threats remain, however, and some categories (such as small electronics and music) could be at significant risk of being hollowed out by the changing ecommerce landscape. Bulky goods (Good Guys) are likely to come under pressure from the slowdown in residential development applications and commencements.

2 Afterpay Touch

ASX code APT
Price $6.52
52wk ▲ $7.00
52wk ▼ $2.65
Mkt cap $1bn
Dividend -
Dividend yield -
PE ratio -
HOLD

For those looking for a growth company with exposure to the retail sector, it may be worth your while investigating Afterpay Touch. Afterpay is a digital payments system that provides consumers with short-dated, interest-free, unsecured credit at the point of sale but without the manual credit checks required by banks for products like credit cards.

Afterpay has grown rapidly over the past two years. From a standing start it annualised over $1.5 billion of purchases in the September quarter 2017, which is around 7% of the value of all online transactions, excluding groceries, in Australia.

Afterpay is using its first-mover advantage to build strong brand awareness with consumers and retailers, evidenced by its name being increasingly used as a verb – Afterpay it! While its current share price is factoring in a substantial increase in earnings, the product has significant growth potential, which in the current retail landscape is certainly a rarity.

3 Myer

ASX code MYR
Price 65.5¢
52wk ▲ $1.34
52wk ▼ 60.5¢
Mkt cap $583m
Dividend 5¢
Dividend yield 7.6%
PE ratio 46.79
SELL

Myer is now knocking on the door of irrelevancy. To prove the point, the loss of a Myer lease at a shopping centre in Sydney's Hurstville saw the space reformatted and relet to mini-majors and specialty food stores, with revenue almost tripling.

Myer's strategy involves reducing space or closing more stores. Whether it is imposed by management or consumers, whose habits are changing, it appears destined to be a smaller business.

The "New Myer" strategy appears not to be working to stave off declines. In December, the most important month of the year for department stores, when sales should be up, they actually declined after a slight increase in November. As a result the company has reported that net profit after tax for the first half of the 2018 financial year will be "materially below the previous corresponding period".

Many analysts are now forecasting the company will suspend its dividend. A significant turnaround is required to prevent Myer shrinking into retailing history.