VALUE.ABLE **Roger Montgomery**

SECTOR ECOMMERCE

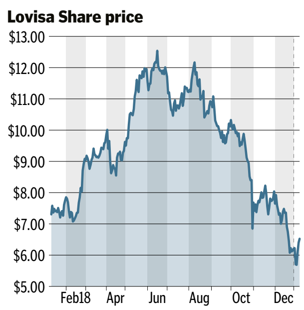
An unstoppable sales force

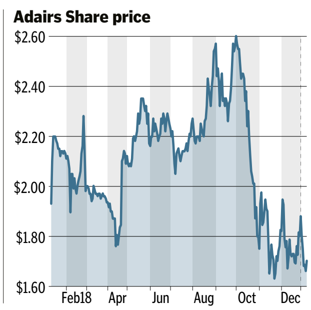
Both investors and shoppers could be winners as online retailers conquer new territory

From pet food to motor vehicles, retailers have approached online opportunities with the same attitude as the apocryphal man with a hammer who finds all problems are a nail. The biggest questions for long-term investors in retail are: How much spending will migrate online? What products are likely to see the greatest online penetration and therefore which brick-and-mortar sellers are likely to see the greatest disruption? We have already seen what has happened to music and book retailing, which are the categories with the largest online penetration.

The answers to these questions will affect a very large part of the Australian market and certainly many investors' portfolios thanks to the familiarity of some of Australia's best brands.

In the US, investment bank UBS estimates "online" will grow from about 13% of US retail sales today to about 20% by 2022 – just three years away. Ecommerce is therefore set to grow by an aggregate 15.4% a year – much faster than the broader economy and significantly faster than the expected aggregate 1% growth of brick-and-mortar stores.





Getting ecommerce right, therefore, offers investors the opportunity to profit, provided of course optimistic assumptions aren't already factored into prices.

At the outset I should note that I don't subscribe to the thesis that online will kill brick-and-mortar stores entirely. We are already seeing successful retail concepts emerge despite the power of ecommerce. Think about the fast-fashion jewellery chain, Lovisa. With a low price point and the instant gratification that spur-of-the-moment purchasing provides, Lovisa has demonstrated a successful formula that it is rolling out globally. Nevertheless, plenty of retailers will be disrupted and I cannot help wonder whether that is why the Lowy family departed the retail real-estate game when they did.

According to UBS, 40% of shoppers still appreciate the ability to see and feel products in store before purchasing them and higher online penetration rates of 30% could be achieved by a few categories such as toys, groceries, footwear, pet supplies and sporting goods.

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

1 Lovisa

ASX code LOV
Price $6.53
52wk ▲ $12.53
52wk ▼ $5.62
Mkt cap $713m
Dividend 27¢
Dividend yield 4%
PE ratio 19.7

HOLD

With net cash and a near 70% return on equity, Lovisa demonstrates very high-quality characteristics. Potential investors need only to establish how long any competitive advantage Lovisa presently enjoys can last. Christmas is believed to have been tough for all retailers and as Lovisa is on a high multiple any sharp reaction could be an opportunity for those with a long-term belief in the company's quality.

2 Greencross

ASX code GXL
Price $5.46
52wk ▲ $6.56
52wk ▼ $3.58
Mkt cap $657m
Dividend 15.5¢
Dividend yield 2.84%
PE ratio 31

SELL

In 2016 the industry body Animal Medicines Australia reported that two-thirds of Australian households owned one or more pets. They spent more than $12 billion on their pets that year, with 35% going on food and 18% on veterinary services. But last year Amazon commenced selling pet supplies for dogs, cats, small animals, birds, fish and even reptiles. Greencross appears expensive too.

3 Adairs

ASX code ADH
Price $1.74
52wk ▲ $2.71
52wk ▼ $1.53
Mkt cap $294m
Dividend 13.5¢
Dividend yield 7.6%
PE ratio 9.65

SELL

According to UBS, bath and bedding (think towels and pillowcases) is another category where bricks-and-mortar stores face great risk. For Australian homewares brand Adairs, there's also the housing construction and property price slump to contend with. The stock appears cheap having already fallen 35% from its October 2018 highs but conceptually there is a reasonable risk of further downgrades this year.

Prices as at close of business, 14-Jan-19. Charts as at close of business 9-Jan-19.