

Global Equity Observer

Amazonians at the gate?

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CEO Jeff Bezos' vision of the e-commerce business he launched being 'The Everything Store' looks set to enter the next major phase as its assault on the grocery segment gains momentum, highlighted by the recent acquisition of a U.S. supermarket chain with branches in the U.K. and a focus on healthy eating. At 30%, grocery is the largest component of the \$2.5 trillion that U.S. consumers spend annually.¹ Looking back at where it all started, i.e., with books, the smallest segment of U.S. consumer spending, and how the group has systemically gone on to dominate each segment it has targeted, the working assumption is that this online retail giant could succeed. Already today, the company accounts for 5% of U.S. personal expenditure, 33% of U.S. online expenditure and 50% of the growth in U.S. consumer expenditure.¹

For us, the interesting question here is how this e-commerce behemoth's move into grocery may impact Staples companies. Our conversations with CEOs of Staples companies have been dominated by the question of how this Seattle-based business may affect the way consumers shop and how the providers of branded products can adapt to this change.

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¹ Source: U.S. Bureau of Economic Analysis, 2015.



We believe there are many U.S. Staples companies, particularly in Food and Household Products, which are ill-prepared for the retail website's push into grocery. We believe these faults will be exposed in the following ways:

- Targeting the center of the store. The center aisles are often populated with auto-replenished products such as detergents and cereals, products that lend themselves to online ordering and delivery. Relentless pressure from the online giant's price algorithms will, we suspect, lead to a rise in private label from the current 19% of the retail shelf in the U.S. toward the close to 40% of Europe.
- The arrival of voice control. This reduces the physical/visual part of branding, which will likely narrow the product range. Just think how many brands of shampoo one can remember compared with the number offered on a webpage or in a store. If voice is successful, the infinite shelf could become a very narrow one, threatening second tier brands in each category.

We believe that our portfolio is largely insulated, with only a small percentage of our Consumer Staples exposure, and total exposure, vulnerable. As a result, we remain comfortable with Consumer Staples as the core element of our global portfolios:

- Tobacco cannot be dis-intermediated for regulatory reasons; alcoholic beverages are problematic to sell online in the U.S. Beauty is a brand-driven, limited, private label category, as are health, hygiene, personal care and spirits. We have just 3% portfolio exposure to U.S. food.
- 42% of our Staples exposure is in stocks that are much more geared to emerging markets (~50% of sales), rather than the U.S. (only 25% of sales), where the Seattle-based e-commerce site is most active.
- Superior products and efficient marketing remain the best way to mitigate pricing pressure. We choose Staples companies where we believe management fosters an entrepreneurial and decentralized culture that pushes innovation, in turn helping drive pricing power.

“Skewed to what we think are the more agile and innovative companies in Staples, we believe that our portfolio is largely insulated.”

For several years, our focus has been on companies we believe are less vulnerable to the disruption of private label, changing distribution patterns and the challenges emerging from online marketing. This threat is just another variant of the same theme (albeit a very significant one). This is the reason we are underweight in the more exposed food and home care sectors. In particular, we have significantly reduced our weighting in food over the last three years in response to valuation and disruption risk. Our emphasis on the more agile and innovative companies in Staples versus the cost cutters and the food names has been reflected by our strong relative performance in Consumer Staples this year.

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