

Retail disruption set to escalate

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The threat of Amazon's arrival has heightened the intensely competitive retail landscape in Australia and highlighted the laggard nature of some local online offerings.

After months of speculation, Amazon recently placed an advertisement on its Australian website announcing it would bring Amazon Marketplace to Australia. Although Amazon has not confirmed the timing of its launch, using its entry into Spain as a guide, suggests the first expanded services could be available here within 12 months.

The looming threat of Amazon further heightens the already intensified competitive retail landscape in Australia which has been hit with a wave of global entrants over the last six years, including the likes of Zara, Uniqlo, H&M and Sephora. While most of these retailers have a predominantly bricks and mortar apparel offering, Amazon is a different beast altogether. It has a breadth and depth of retail offering unlike any other retailer globally and it is renowned for its competitive pricing and speedy delivery. Australian retailers in contrast have been slow to develop a competitive online offering with many still lagging sophistication on fulfilment and delivery capabilities.

For the financial year to date, the Australian discretionary retail sector has underperformed the broader share market (as measured by the S&P/ASX 200 index) by -11% and by -13% for the calendar year to date (CYTD), posting actual returns of 7% and -6.4% respectively. While retail conditions have been challenging, the underperformance CYTD has been driven more by price to earnings (PE) multiple compression than earnings disappointments. The PE compression largely reflects the market's concerns about Amazon's Australian entry. Multiples will stay largely compressed until Amazon is up and running and the market can more accurately assess the financial impact on sales and margins.

The rise and rise of Amazon

Amazon now has a market value of US\$450 billion, while its share price has risen from US\$200 in 2012 to more than US\$900 currently. Amazon says its focus is on customers rather than competitors and that it has no market share targets. A recent statement from Amazon said: "We are optimistic that by focusing on the things we believe customers value most - low prices, vast selection and fast delivery - over time we'll earn the business of Australian customers."



Photo: Bloomberg

Retail disruption

Will the US experience repeat here in Australia?

Amazon is bigger than most bricks and mortar retailers put together



Market value as of 30 December 2016

Stock	Price Return Dec 2006 to Apr 2017
Amazon	+2,200%
Sears	-89%
JC Penny	-93%
Nordstrom	-4%
Kohl's	-42%
Macy's	-23%
Best Buy	5%
Target	-3%
Walmart	+63%

In the United States, Amazon accounts for almost 5% of total retail sales and 38% of online retail sales, while its share of UK retail spending is estimated to be around 3.5%, with its share of online sales at 24%. Macquarie Equities has estimated that Amazon's Australian sales could reach \$14.5 billion by 2025, representing about 25% of online sales.

According to Hitwise data, the most popular categories for Amazon shoppers in the US are Kindles, health and beauty, consumer electronics and groceries. For Australian shoppers viewing Amazon's US website, the top categories (excluding Kindle) are paperbacks and hardcover books, computers, electronics, toys, health and beauty and apparel. Amazon has the largest market share of online apparel revenue among shoppers aged 18-34 years on US retail sites.

Total annual retail sales in Australia are \$300 billion. JB Hi-Fi has \$3.9 billion in annual sales, Super Retail Group has \$2.5 billion and Harvey Norman \$1.8 billion. All three sell goods which are commonly available on Amazon's offshore websites.

What to expect

Amazon Web Services launched in Australia in 2012, followed by a Kindle Store on Amazon.com.au in 2013 and it currently has 1000 employees here. According to Amazon: "the next step is to bring a retail offering to Australia, and we are making those plans now."

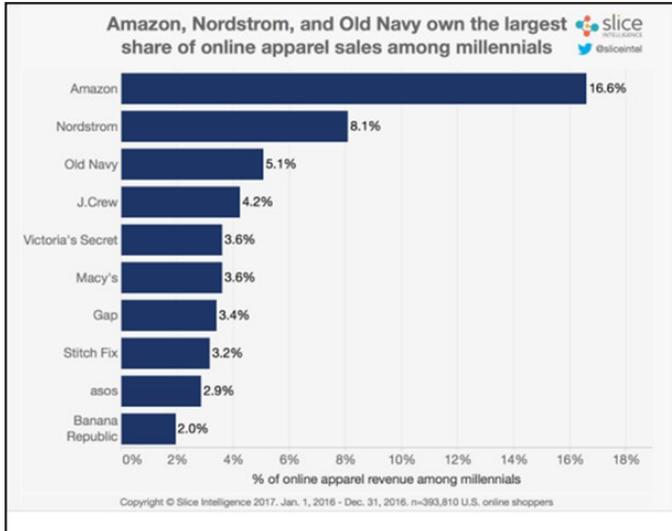
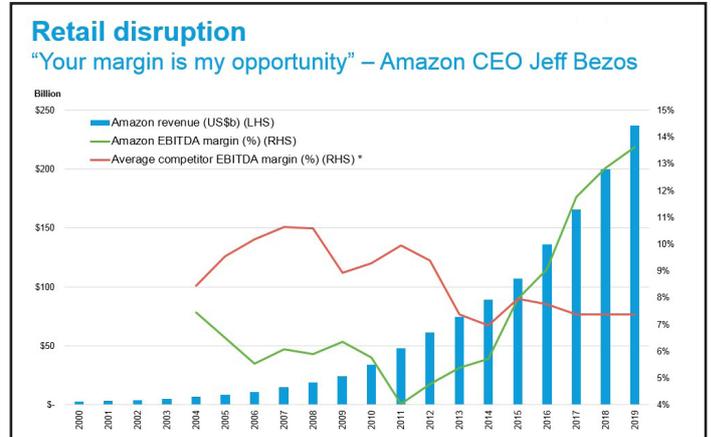


Chart 2 reference - Slice Intelligence's online shopping ranking - Slice Intelligence

We understand that Amazon is actively looking for a warehouse to become a fulfilment centre (the first of many in Australia), with floor space of up to 93,000 square metres, or the equivalent of about five MCG's. Analysts estimate that Australian consumers already spend between \$700 million and \$1 billion per annum on Amazon.com.au and Amazon's overseas sites. Given Amazon's strengths in books, consumer electronics, clothing and sporting goods, the bricks and mortar retailers that are most exposed will include JB Hi-Fi, Harvey Norman, Myer, Dymocks, Super Retail, BIG W, Kmart and Target.

Looking at Amazon's entry into Spain provides some interesting insights. Amazon announced its entry into the Spanish market in September 2011 and then opened a 28,000 square metre distribution centre five kilometres from Madrid's Barajas airport 14 months later, offering two and three day shipping through subscription service, Amazon Prime. Amazon initially sold Spanish consumers products such as books, CDs, DVDs and consumer electronics. It now sells about 175 million products, including clothing, toys, homewares and hardware and employs more than 1000 people.



Retail outlook

Australian retailers have been through turbulent times in recent years. The threat of online retailing was accentuated by the AUD trading above parity against the USD in 2012 creating significant investor anxiety. The PE multiples of mature discretionary retailers substantially de-rated between 50% and 100%, with material EPS downgrades driving a significant increase in short interest.

This time around the difference is that an online offer to varying degrees has been adopted by all Australian retailers, while Amazon's domestic presence will remove the exchange rate arbitrage that Australian consumers were playing when our currency was previously significantly higher than it is today.

News flow about Amazon's entry plans will gather pace over the coming twelve months and will continue to weaken the market's appetite for retail exposure despite the fact that valuations are starting to look enticing. In addition, there is risk of a general slowdown in consumer spending given the weak outlook for wages growth and a potential fall in consumer confidence driven by rising interest rates and the possible stagnating or contracting of housing prices.

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