Investment Insight

Friday, 7 July 2017

ARIA | CAPITAL

Food for thought. *Amazon caused quite the commotion recently buying Whole Foods in America; however, it would appear that Amazon's actual target is not Whole Foods per se, but everything we buy. This might appear a little sensationalistic, but it seems the threat to the broader retail market is very real. Investors took to the side-lines following the announcement resulting in a broad sell-off across the food retail sector.*

A recent report from a well-respected transportation industry consultant told attendees of a logistics conference that Walmart is telling trucking companies it will no longer do business with them if they continue moving goods for Amazon. Bloomberg's Conor Sen provides some colour on the Whole Foods deal in the context of the broader sector in ***The Inside track.***

Catastrophe: *Insurers, reinsurers and institutions such as the California Earthquake Authority sell catastrophe bonds to spread the risk of paying out on hurricanes, earthquakes and floods. In recent times new issuances of such securities in the US reached an all-time high of $3.4 billion in May, pushing sales in the first five months of this year to $7.9 billion. This is approaching the record for the whole of 2014. This week's* ***Pic of the Week*** *takes a closer look.*

Quoted...

"The quickest way to double your money is to fold it over and put it in your pocket" - Will Rogers

The Inside Track

The recent bid for Whole Foods by Amazon has send shockwaves across the food sector as many companies believe the threat posed by Amazon is considerable. While this may be true, it wold appear that it is not only the sector that should be concerned as Bloomberg's Conor Sen points out.

The really tempting margins are in consumer products. Look out, Procter & Gamble and Colgate-Palmolive." Your margin is my opportunity." This aphorism favored by Amazon founder and CEO Jeff Bezos is the lens through which we should evaluate Amazon's intention to buy Whole Foods. After the announcement on Friday, investors were harsh on grocery stores and big box retailers -- but it's not their margins in which Amazon sees an opportunity. This modern conglomerate is not primarily going after the stores, but the products on the shelves.

Grocery stores are a notoriously low-profit-margin business. Kroger, which had $115 billion in revenue in its most recent fiscal year, showed a net profit of just under $2 billion, for a profit margin of under 2%. Costco, with its lucrative membership revenue stream, earned just $2.35 billion on revenue of $118.7 billion, also a profit margin around 2%. There's a reason e-commerce has had a difficult time disrupting this business.

Some may be collateral damage, but it's not the mass grocers that have the most to worry from Amazon buying Whole Foods. It's the higher-profit-margin consumer packaged-goods companies. In its most recent fiscal year, Procter & Gamble earned a juicy $10.5 billion on $65.3 billion in revenue. Colgate-Palmolive earned $2.4 billion on $15.2 billion in revenue. There were already questions about how robust the "moats" of these companies were -- the barriers to entry for potential competitors -- and the Amazon-Whole Foods merger would show at least one barbarian can make it over the gate.

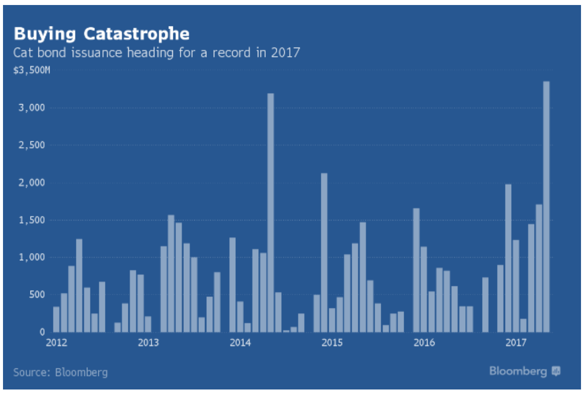
The entrenched consumer packaged-goods companies have large market shares based on an economic and distribution model that is breaking down. Until now, if you sold the most product you could benefit the most from economies of scale, allowing you to lower prices or expand profit margins. And if you earned the most money you could spend the most on mass marketing and buy up all the shelf space at grocery and big box stores. Upstarts would have to overcome three daunting challenges: higher production cost per unit, low brand recognition and difficulty getting shelf space.

But that's changing, in part because of Amazon. With its Amazon Basics brand, Amazon is already gaining significant market share in diapers and batteries. They could extend the Amazon Basics brand to other categories, and push that out to Whole Foods stores. In food, Whole Foods has already created the "365" private-label brand. That's another vehicle for Amazon to attack high-margin major brands.
An Amazon-Whole Foods marriage would merge some of the aspects of e-commerce and brick-and-mortar retail. Using its sales data, Amazon can curate the products it sells in Whole Foods stores, where shelf space is a constraint. Maybe that means Procter & Gamble products, maybe that means low-margin Amazon Basics brands, or maybe it means emerging brands that are more popular and/or cheaper than some of the current market leaders. Other grocers like Kroger, Safeway and Wal-Mart might have real estate that Amazon-Whole Foods doesn't, but they're going to be watching every decision by Amazon-Whole Foods, just to stay competitive.

If Amazon and Whole Foods disrupt the grocery business, it won't be because of their market share, which combined is under 2%. Instead, it'll be because of their as-yet-unknown effect on consumer products -- dictating what we buy, and how much we pay.

Pic of the Week

While no one has the ability to accurately predict catastrophic events such as earthquakes or hurricanes, it is clear that the chase for yield continues in some of the more unusual places. In the "catastrophe bond" market, defaults are rare and investors have enjoyed above-average returns in recent times. In a low interest rate environment demand for such non-traditional investments is likely to continue.



Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	-0.2%	+17.3%	+7.5%	+10.1%
US equities	-1.3%	+14.8%	+7.6%	+12.2%
European equities	+0.6%	+19.7%	+5.6%	+8.0%
EM equities	-0.4%	+23.3%	+17.1%	+1.3%
Irish equities	+0.4%	+26.3%	+5.1%	+16.6%
Commodities	+2.0%	-9.9%	-5.8%	-9.6%
Hedge funds	-0.2%	+5.6%	+2.6%	+1.9%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.9%	+0.2%	+7.2%
Germany	+0.6%	+1.6%	+1.7%
USA	+2.4%	+1.9%	+2.1%
China	+3.6%	+1.5%	+6.9%

Week ahead: Key events

10/07 China CPI & US Labour Market Conditions
11/07 US Wholesale Inventories
12/07 Australia Consumer Confidence & UK Employment
12/07 US Mortgage Applications
13/07 Germany CPI & US Initial Jobless Claims
14/07 Japan Industrial Production
14/07 US CPI & Retail Sales
14/07 US Manufacturing Data

Currencies	*Current*	*YTD Δ*
EUR:USD	1.14	+8.6%
EUR:GBP	0.88	+3.2%
EUR:CNY	7.76	+5.7%
GBP:USD	1.30	+5.1%
Bitcoin	2,596.52	+172.9%

Commodities	*Current*	*YTD Δ*
Gold	1,225.26	+6.3%
Copper	5,814.00	+5.3%
Oil	47.91	-18.6%
Wheat	539.00	+20.4%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

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