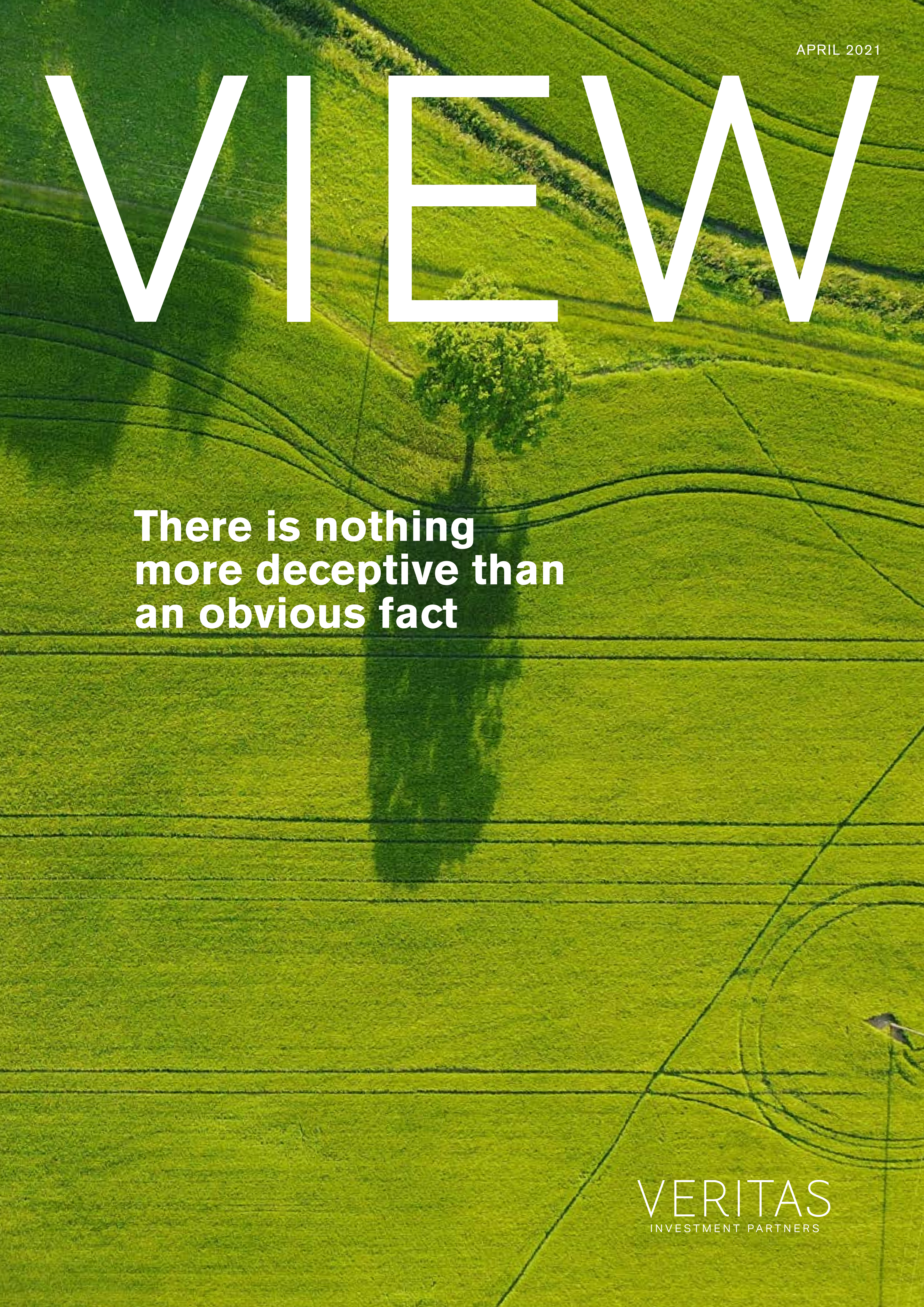
APRIL 2021

# VIEW



## There is nothing more deceptive than an obvious fact

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# ECOMMERCE TO 'EVERYWHERE COMMERCE'

"Goodbye virus-ridden 2020, hello Roaring Twenties"[1]. The Financial Times was not the only culprit for this comparison, and one can certainly see its merits. A century ago, large parts of the world had endured the collective trauma of conflict followed by a worldwide pandemic. What ensued, in the major cities at least, was a consumption boom and years of economic prosperity. Notably, this boom was underpinned by technological advances and social revolution, which opened up all kinds of new ways for consumers to spend their time and money. Iconic franchises from the 1920s reflect the changing times: Ford and the Model T; AT&T and the telephone; Chanel and perfume; Chaplin and the movies. Drawing parallels between then and now is certainly appealing. After the year everyone has had, you can't blame the FT and others for wishing for similar prosperity.

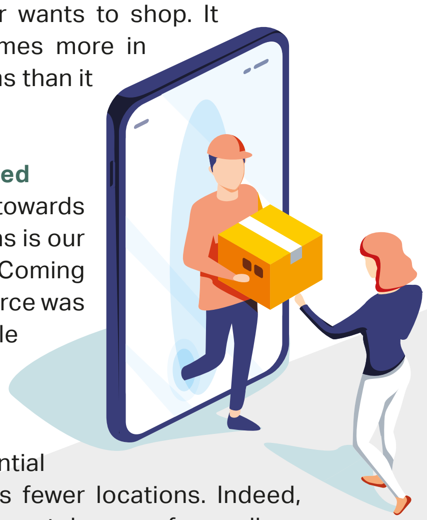
With savings rates up, it is tempting to try and guess when and how consumers will 'splash the cash'. As ever, you won't find us making economic forecasts or trying to predict what the latest consumer craze will be. Such forecasts and trends are inherently uncertain. However, with consumer spending accounting for upwards of 60% of GDP in developed economies[2], it is interesting to consider how major changes in the way people shop, interact and entertain themselves can affect the companies and sectors we are invested in. Digital transformation is a common thread throughout the structural growth trends we look at and there are few places where the pace of change has been more evident than in our own habits.

### There is nothing more deceptive than an obvious fact[3]

Our willingness to spend an increasing amount of both our time and money online has been a defining feature of the past decade. With few other options, it has also defined our past year in lockdown. With worldwide eCommerce penetration pegged at less than 15% heading into COVID and still less than 20% coming out[4], there remains clear runway for growth in online spend as people continue to gravitate towards favouring the screen over the store. But whilst the trend may seem obvious, the conclusions are far from it.

The high street has suffered as footfall has dried up over the years. But our online 'footsteps' have equally disruptive consequences. eCommerce has been called the 'endless aisle' on account of the seemingly limitless choice of products on offer. For consumers, this is great in theory but in practice can be troublesome. When every option is possible, how do we find what we want? In a world of abundance, we find it no coincidence that, thus far, some of the greatest online winners have been those that pull together consumers and retailers all in one location. Looking at the top 20 eCommerce retailers, 80% of their sales come from this 'marketplace' model of selling third party brands all in one place[5].

**Next** has many qualities as a retailer, but in the digital world we believe it to be particularly well positioned. With more than 60% of the business already coming from online sales, and a burgeoning reputation as a quality platform for 1,300 third party brands[6], Next has positioned itself to be ready for wherever and whenever a consumer wants to shop. It now invests over three times more in warehousing and IT systems than it does in its stores[7].



### When retail goes palm-sized

Exacerbating the trend towards fewer shopping destinations is our fixation with our phones. Coming into 2020, 45% of eCommerce was being done through mobile phones, almost double the amount only 5 years ago[8]. When retail becomes palm sized, it has the potential to further push us towards fewer locations. Indeed, outside of social media, our tolerance for endless scrolling seems to be limited: a third of Amazon shoppers click on the first product listed[9]! This consumer convergence towards only a few providers creates ripple effects for all those trying to sell online and has the potential to squeeze out many companies.

That is not to say strong brands will be unable to stand

1. Financial Times 01 January 2021
2. https://data.oecd.org/hha/household-spending.htm
3. Sherlock Holmes in Arthur Conan Doyle's "The Adventures of Sherlock Holmes"
4. eMarketer Global Ecommerce Update 2021
5. WSJ / Activate Technology & Media Outlook 2021
6. Next Plc Full Year Results 2021
7. Ibid
8. Bernstein "eCommerce Outlook: Just how permanent is the pull forward?"
9. https://www.searchenginejournal.com/amazon-search-engine-ranking-algorithm-explained/265173/

out from the crowd. Footwear icon Nike and beauty powerhouse L'Oréal have maintained their preeminent positions in the face of all this disruption. Their ability to not only navigate the shift online, but also build strong relationships with consumers, suggests to us that not all retail is destined to be done through one website or app. L'Oréal has managed to reach 1 billion users through its virtual tool for people wanting to try on make-up before buying[10]. Both companies are in our universe of fully researched companies, awaiting an attractive entry point.

### The 31-hour day?

The fact that there are 24 hours in a day seems an immutable fact; and yet a study found that multitasking and interaction with the internet has led to a 31.5 hour day for the average American. An incredible 12 hours of which is spent on some form of consumer internet / media activity[11]. With such an enormous chunk of our day now being spent digitally, it is no surprise that advertising dollars have followed us there.

As Henry Ford said, *"Stopping advertising to save money is like stopping your watch to save time"*. Most companies that want to capture a slice of online consumer spending will have to advertise in some form or another. Indeed, it is our continued willingness to spend time and money online that makes it such valuable real estate. When we consider who the new landlords are, **Alphabet** (Google's parent company) remains well positioned as a key piece of the advertising ecosystem. By 2019 there were 175 online mattress companies[12], which tells you that it has never been easier to start a new digital brand. With no need for an actual shop or front of house staff, but a desperate need to attract customers, these 'digitally native' companies spend up to 70% of sales on digital ads[13].

As the traditional advertising model has been disrupted, companies are taking vital marketing skills in-house and looking for a partner to help. **Accenture** has been able to capitalise on this blurring of the lines between marketing and technology and has built a business equivalent to the fourth largest ad agency in the world[14]. In a world where digital interaction with consumers is paramount, Accenture Interactive is helping its clients provide a consumer experience that makes them stand out in the 'endless aisle'.

### eCommerce to 'Everywhere Commerce'

For all the talk of the death of retail, we find it interesting that in between lockdowns, people still returned to stores. In the UK, in-store sales got back to 100% of 2019 levels in household goods, and close to 80% in apparel[15]. So, whilst eCommerce is an obvious trend, we see the 'new normal' of shopping to not necessarily

be a binary choice between online and offline. Rather, companies that can provide the most convenient and accessible way to shop, however consumers want to do it, will be best positioned to weather further disruption.

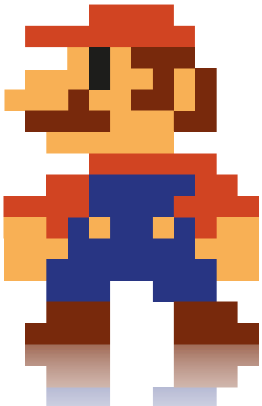
It is here we find **Tractor Supply**'s success in 'omni-channel' retail particularly interesting. The Company has built its track record providing rural and suburban Americans with everything they need to look after their land and animals. At the same time, it has been investing in IT and infrastructure to ensure that the online is seamlessly connected with the offline. Its almost two thousand stores have become the warehouse: 70% of online orders are actually picked up in-store by its customers[16]. Not only is this lower cost for the company, but it can also be more convenient for customers who may wish to make returns, shop for extra items or get advice on the products they are buying.

Indeed, when the bill comes due, it appears convenience has its pitfalls. It is estimated that the cost of returns annually amounts to $1trn[17]. Buying three colours only to return all of them for a different size can add up when factoring in delivery and other processing costs. Hence the beauty of turning physical stores into assets of the online business. Returning to **Next**, 80% of online orders are returned in person to one of its stores[18]. Even Amazon is getting in on the game: since 2019 Amazon customers have been able to collect their parcels directly from Next's stores.

Behind every great retailer is a great logistics operation. To help retailers know where their inventory is, and to stop it being 'held hostage' in different channels, RFID technology has emerged as a key enabling technology. **Avery Dennison** is the leading global manufacturer of these tiny labels that allow an item to be tracked. The labels cost as little as 4-5c each, but with Nike requiring 1bn a year to go in every pair of trainers produced, the potential market is huge[19].

10. https://www.wsj.com/articles/loreal-applies-digital-makeover-to-sales-efforts-11605046234
11. WSJ / Activate Technology & Media Outlook 2021
12. Benedict Evans "Standing on the Shoulders of Giants"
13. Bernstein "Tip of the digital advertising iceberg"
14. https://www.campaignlive.co.uk/article/accenture-interactive-returns-growth-six-month-decline/1703300
15. Redburn "Thinking Allowed. Gradually, then Suddenly. The Online Step Change"
16. Tractor Supply
17. Shopify "The future of ecommerce in 2021"
18. Next Plc Full Year Results 2021
19. Avery Dennison

# ARE YOU NOT ENTERTAINED?



What do sleep, video game Fortnite, Disney and TikTok all have in common? Over the years, they have been described by Reed Hastings, Netflix CEO, as main competitors to his video streaming service. Such competition for our attention is likely to remain fierce as demand for entertainment not only increases but is disrupted by companies seeking a slice of the more than $600 billion consumers spend on accessing content each year[20].

Being locked up at home meant that worldwide streaming subscriptions passed the 1bn mark in 2020, with those who subscribe now signing up to an average of five services, up from just three before the pandemic[21]. But holding onto those subscribers will be harder than ever: 21% of people cancel because of better content elsewhere[22]. And that's before the pubs reopen! Although known for its Nerf guns, it is **Hasbro**'s role as an 'arms dealer' of content to all platforms that means it is well placed to benefit wherever consumers decide to watch their favourite shows. You are as likely to be watching Hasbro's content on terrestrial TV as you are on Netflix, Disney+ or Amazon Prime. Furthermore, all that time spent watching Peppa Pig and other shows, also makes Hasbro the Number 1 kids content owner on YouTube[23].

But as Mr Hastings points out, the competition for eyeballs is no longer narrowly defined to traditional sources of entertainment. For those people not spending their extra time binge-watching the latest shows, video games have been an alternative outlet. Although deemed another pandemic 'winner', the time and money spent on gaming has been steadily rising for many years. With the number of gamers now at 3 billion worldwide (and growing)[24], they no longer fit the stereotype of the basement-dwelling misfits. **Microsoft**'s Xbox Live platform alone connects 100m members all over the world and new technology means that you will soon be able to stream console quality games directly to your phone[25]. Gaming has also turned into a spectator's sport: **Alphabet** reported that 100bn hours of video game content was viewed on YouTube during 2020, up 100% from two years ago[26].

## What's past is prologue[27]

In The Great Gatsby, the fictional embodiment of the previous twenties, Jay Gatsby asserts: *"Can't repeat the past? Why, of course you can!"* Whether you would want to is another matter. For all the prosperity of the roaring twenties, the decade still contained peaks, troughs and irrational exuberance. This is why we consistently look to the future, identifying quality companies that can prosper regardless of whether they fit into the latest trend or narrative. Whilst we all have a great deal of optimism and hope for the years to come, we recognise that very little happens in a straight line. Protecting and growing our clients' capital means therefore we remain as focused on risks and valuation discipline, as we are on the opportunities.

Written by **James Moncrieff** and **Catriona Hoare**
*on behalf of the Investment Team*

20. WSJ / Activate Technology & Media Outlook 2021
21. MPAA 2020 report https://www.motionpictures.org/wp-content/uploads/2021/03/MPA-2020-THEME-Report.pdf
22. Ibid
23. Hasbro Investor Day 2021
24. https://www.ign.com/articles/three-billion-people-worldwide-now-play-video-games-new-report-shows
25. Microsoft Q2 2021 earnings call
26. https://blog.youtube/news-and-events/youtube-gaming-2020/
27. Shakespeare "The Tempest"

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