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Despite the rise of e-commerce, brick-and-mortar retail ain't dead yet

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Patrick Crocker, co-founder and managing director of MHT Partners. Photo courtesy of the firm.

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It's a well-worn adage among investors on Wall Street that e-commerce retailing, dominated by Amazon, is killing brick-and-mortar stores.

While that's true for some retailers, a closer examination suggests that the rumors of the death of retail stores may be premature.

From giant Walmart to discount chain Dollar General, many well-run retailers are not only surviving the challenge from Amazon but are actually thriving.

For example, in 2013, Walmart had 4,005 stores. That number was 4,761 stores this year — an increase of 19 percent. In the same period, Dollar General's store numbers rose 38 percent to 15,509 from 11,215.

For any PE investor taking the contrarian view that physical retail is not going away, the opportunity is compelling.

Whether it's Home Goods, where consumers find top-brand home furnishings for bargain prices, or cosmetics-and-beauty store Ulta, people are still out in their local neighborhoods spending their hard-earned cash.

Indeed, data on five leading retailers shows that over the past five years, total store count has increased more than 30 percent, a compound annual growth rate of 5.4 percent.

Walmart, the world's largest retailer, has enjoyed 15 consecutive quarters of positive same-store sales growth, with the strongest periods during the past 18 months.

Countering that narrative are media headlines that regularly inform us of the tough times facing retailers.

As 24/7 Wall Street writes, "In what many have dubbed the 'retail apocalypse,' brick-and-mortar retailers across the United States have been forced to reduce their footprint in order to maintain profitability in recent years.

"In the most extreme cases, several well-known brands have had no choice but go out of business entirely. Since the beginning of 2017, major companies, including RadioShack, Payless ShoeSource, Toys 'R' Us and Bon-Ton, have filed for bankruptcy protection."

While that may be true, bankruptcies result more from poor management than competition from Amazon.

Some stores are doing well because like Walmart they can offer great prices. Others, like Target and Costco, constantly replace inventory in stores to create a treasure-hunt shopping experience for customers.

Other retailers focus on a niche, like Total Wine and More and Ulta Beauty, where the in-person experience helps sell the product in a way online stores cannot match.

As the *New York Times* notes, “Just 8.9 percent of retail sales in the United States last year were made online — including Amazon. Said differently, 91.1 percent of the $5.7 trillion consumers spent at retailers last year still passed through brick-and-mortar locations.”

There are reasons to be optimistic about retailing, not least because Americans *love*to shop.

An NPR/Marist Poll published in June showed that a majority (56 percent) of people who shop online would in general prefer to shop at a store rather than online, while 37 percent prefer to buy online. That majority view was broadly shared across people in all income brackets, genders and ages.

Even e-commerce king Amazon sees a future for the in-person brick-and-mortar shopping experience: It acquired Whole Foods for nearly $14 billion and is experimenting with checkout-free Amazon Go stores.

Further evidence of the resilience of retail is seen in the mall industry, where Brookfield Asset Management bought General Growth Properties for $9.25 billion.

And while Warby Parker got its start selling eyeglasses online in 2010, it plans to have 100 physical stores open by this year’s end.

CNBC writes that after many digital-first retailers established themselves online, they are now “seeking out the best real estate after developing relationships with top U.S. mall and shopping center owners.”

From an investment perspective, prices in recent M&A activity suggest that investors’ enthusiasm may have swung too much in favor of pure e-commerce investments at the expense of old-fashioned retailing.

Unilever paid $1 billion for Dollar Shave Club, a five-year old e-commerce company, and PetSmart bought online pet food store Chewy.com for $3.35 billion, the largest purchase of a strictly e-commerce company.

Private equity investors are snapping up pure online retailers, often paying high prices, as much as 5x annual revenue or more, to beat other bidders.

Meanwhile, a vast ecosystem of companies sell into brick-and-mortar retailers, many of which can be bought for more traditional Ebitda multiples. For any PE investor, this is positive news.

If retail is proving resilient, investors should not be too surprised. After all, the sector has survived many previous periods of disruption. Local corner stores were disrupted by department stores, which in turn were disrupted by malls.

Department stores and malls were then disrupted twice, first by catalogs and then by discount department stores. The latest disruption from e-commerce is no more likely to kill the retail store than earlier waves were.

The British nobleman Baron Rothschild, who profited in the panic that followed the Battle of Waterloo against Napoleon, coined the phrase “Buy when there’s blood in the streets, even if the blood is your own.”

When it comes to investing in brick-and-mortar retailing, this could be one of those times.

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