# CAGNY 2021 – Log

## Overview

Every year the Consumer Analyst Group of New York (CAGNY) gathers together the leaders of the top consumer staples firms to discuss their businesses with members. This provides unique access to their current thinking. I am attending this year's virtual version of the event and will report back on my main observations. This log covers day 2 and 3.

## Day 2:

Companies presenting included Kellogg (U.S listed: cereals and snacks), International Flavors and Fragrances (US listed; specialty ingredient supplier), PepsiCo (US listed soft beverages and snacks) and The Hershey Company (US listed: Confectionary).

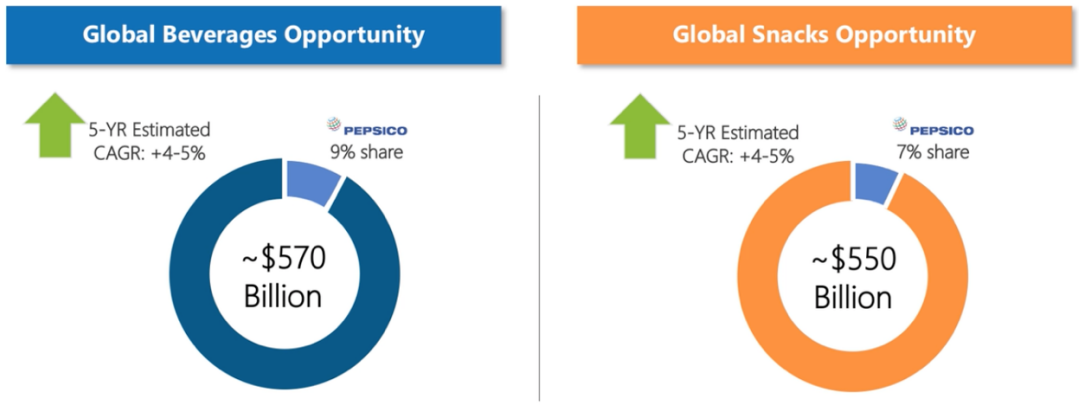
A common theme among the branded producers on this day is that their products are more on the indulgent side than well-being. Whilst this has acted to constrain sales growth, as was a general theme with the companies on the first day, there have been some positive aspects. Whilst consumers are generally looking to be healthier, they have retained desires to reward themselves with what is becoming an industry category byword 'indulgencies. There was also commentary that the younger generation are more pre-disposed to snack; a theme I have definitely witnessed at home. Pepsi had recognised the attractions of snacks some time ago and diversified into the area such that 55% of their revenues are from the same mitigating the maturity of their carbonated cola.

PepsiCo's major brands:


Source: Company presentation

Having reinforced their beverages brand portfolio with higher growth categories such as energy and health-related non-carbonated drinks, they now consider the growth opportunity similar in both areas:

PepsiCo market opportunities:




*Source; company presentation*

Hershey has very strong chocolate brands which have proved robust but have also diversified into healthy snacking in the form of 'skinny' popcorn and are now second in the US popcorn market. They have been a consistent performer with the following algorithm.

*Hershey's growth algorithm:*


*Source: company presentation*

Hershey has a significant family shareholding in the form of a trust who, amongst other matters, demand a long-term view. That said, they remain a very US centric company with only 10% of revenues international.

The Kellogg Company have had a more difficult time having been slow to recognise industry change and in particular the decline of the unhealthy breakfast cereal market. Well-being and natural ingredients have been a key strategy for new entrants in food and beverage and cereal a primary target.

This crisis has invoked a reaction from the company, and I felt the greatest sense of urgency and the need to change of all companies seen so far. They have also diversified into snacks such as Pringles and presented a strategy orientated around data analytics and product innovation. The pandemic drove strong growth in all their businesses including legacy

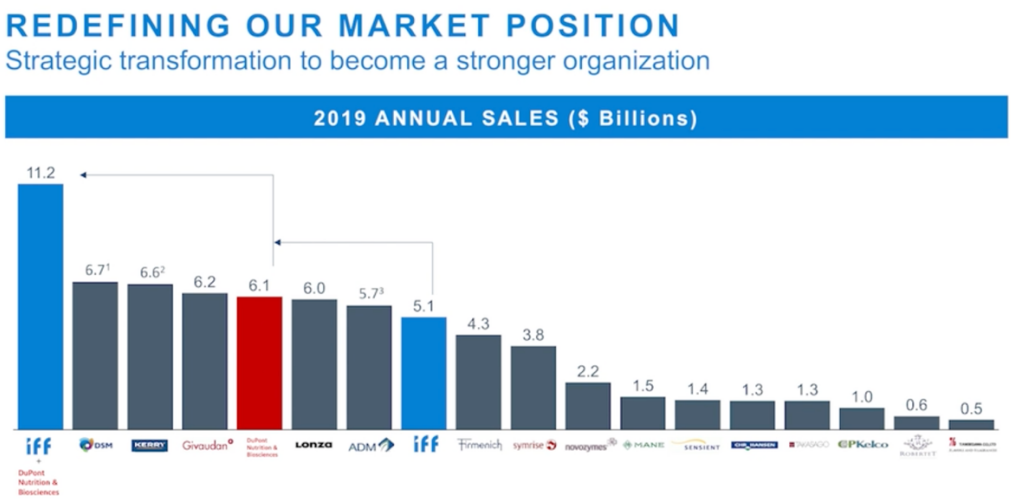
businesses resulting in a significant strengthening of the balance sheet. It is perhaps too early to tell whether they change has resulted in a secular stabilisation and return to growth, but this will be an interesting company to observe closely. Not least, it will provide a test case as to whether digital marketing approaches can aid the turnaround of tired legacy brands.

*Kellogg's refreshed brand portfolio:*


*Source: company presentation*

International Flavors and Fragrances (IFF) were historically the leading speciality ingredient supplier but in the past few decades have been usurped by Givaudan of Switzerland. They have taken a more traditional, but much higher risk, approach to address their short comings: a massive acquisition. They have acquired, through a complex merger arrangement, Du Pont's Nutrition and Biosciences division. This division has higher revenues than the entirety of the prior IFF and propels the company to the largest of the ingredient's suppliers.

*IFF is now the largest ingredients company:*




Source: company presentation

This strategy is high risk and more often than not ends in failure. The disarray and inward focus could provide opportunity for smaller rivals.

## Day 3:

This day involved more tobacco companies and commodity food producers both outside my areas of capability but the company representing one of our fund's largest positions; Procter and Gamble (P&G) presented along with Kimberly Clark and Clorox.

P&G are 20 months into a reorganisation that has entailed reducing and focusing the brand portfolio from 120 to 65 and then applying a defined re-invigoration strategy set out in the following slide:

P&G's well-defined strategy:


Source: company presentation

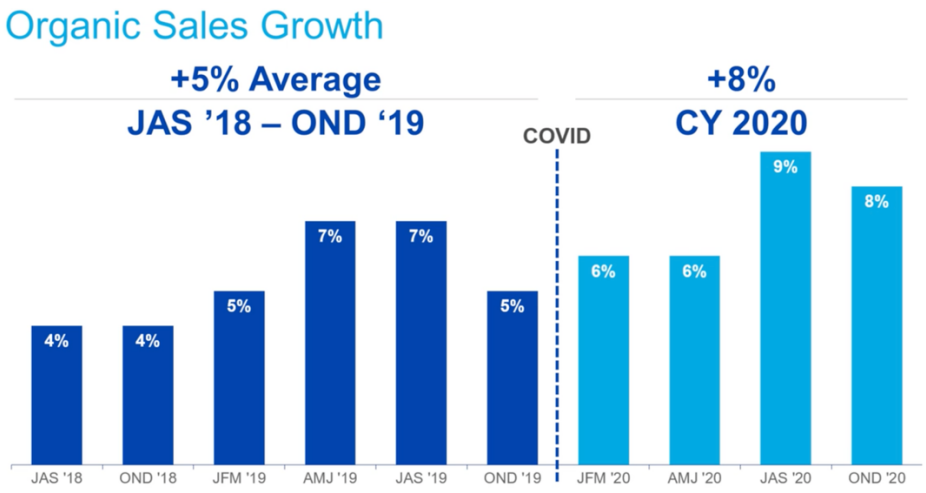
The key is in the practical delivery and the company impressed with a number of actual examples. Digital marketing can be very effective, but products must be great. The company has encapsulated this with innovative developments to standard products such as washing powder where their easy-to-use pods are as effective with cold water thereby saving energy usage. In China they have been adept at using social media and influencers to promote Pantene hair care products, shot face masks and high-end crest teeth whitening products.

*P&G's new range of hair products for the China market:*


*Source: company presentation*

These efforts have translated into higher growth rates than the industry is generally achieving, and this was evident even before COVID boosted demand in certain household areas. I should also mention that P&G, as with many US staple companies but unlike most other US general companies, is proud of its long-term dividend track record and prioritises this as the way to distribute surplus cash. This renders them good candidates for the income segment of our portfolio.

*P&G's recent track record of organic sales growth:*




Source: company presentation

Kimberly Clark and Clorox are both competitors of P&G in diapers and household cleaning respectively. The former achieves good returns on capital although its gross margin is lower at 37% than most in the branded industry. Their presentation emphasised the importance of emerging economies with higher birth rates; however, I was surprised to hear that such countries only comprise 30% of revenues. Worsening developed country demographics is an increasing issue for most staples companies and perhaps Kimberly Clark is a forewarning of things to come. This pictorial summarises the company's view on its markets:

Kimberly Clark core markets:

| Category Size and Relative Growth | | |
|---|---|---|
| Adult Care ($10B) | Depend | +++ |
| Feminine Care ($32B) | kotex | ++ |
| Diapers ($47B) | HUGGIES | ++ |
| Baby Wipes ($7B) | HUGGIES | ++ |
| Facial Tissue ($17B) | Kleenex | ++ |
| Bath Tissue ($51B) | Scott | + |
| Paper Towels ($14B) | Viva | + |

Source: company presentation

Interestingly, the Adult Care (adult diapers) will benefit from aging demographics but is a fifth of the size of the Huggies franchise.

I could almost write exactly the same paragraph for Clorox excepting that it has a more typical gross margin at 46%, has a great return on invested capital profile but is struggling to grow. That said, its core disinfectant brand had a massive surge in growth over COVID resulting in 23% overall sales growth.

Clorox brands are very hygiene focused:


Source: Company presentation