CAGNY 2021 – Log

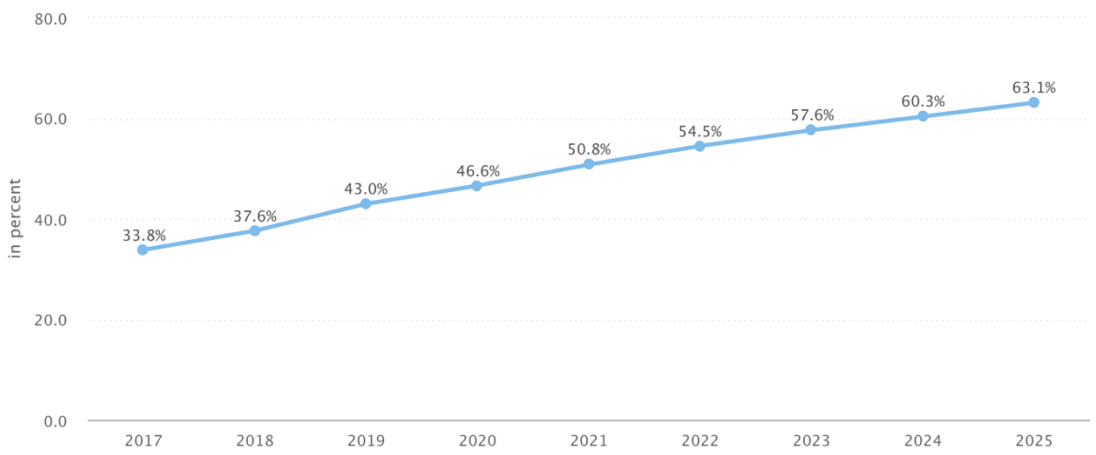
Overview

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 1.

Context

Like most others, staples markets are facing considerable change as a result of digital innovation and increased environmental and social concerns. Using the Porter's five forces framework; the major change is taking place in the 'customers' vector where e-commerce platforms are dislodging traditional retail customers. The winner-takes-all nature of the new business models means that staples companies could suffer a decline in relative power as a few very large customers take the place of multiple 'bricks and mortar' retailers.

Global penetration of e-commerce use:



Source: Statista, adjusted for impact of COVID

Linked to this is the collection of consumer data. Historically, marketing was a core competence of brand led industry leaders and understanding the customer was an integral part of this. However, now the e-commerce and social media platforms are gathering much more, and much more detailed, data, they are threatening to wrestle power from the producers.

The companies also face difficult decisions in the way they present their major brands. Changing the presentation or constituents of currently successful brands can be dangerous; however, an increasing proportion of consumers are demanding greater integrity and purpose in the products they consume especially in respect to the environment.

Bringing this all together, I would suggest that the core business of the staples is not subject to the disruptive forces we have seen in other industries – these companies make the everyday items we cannot live without and their brands are difficult to dislodge.

However, there are risks that they will have some of their strength sapped by the digital giants and that barriers to entry could fall as new entrants ride the green wave as an entry point. The response, as with legacy companies in other industries must be a massive pivot to digital literacy and an openness to new digital business models.

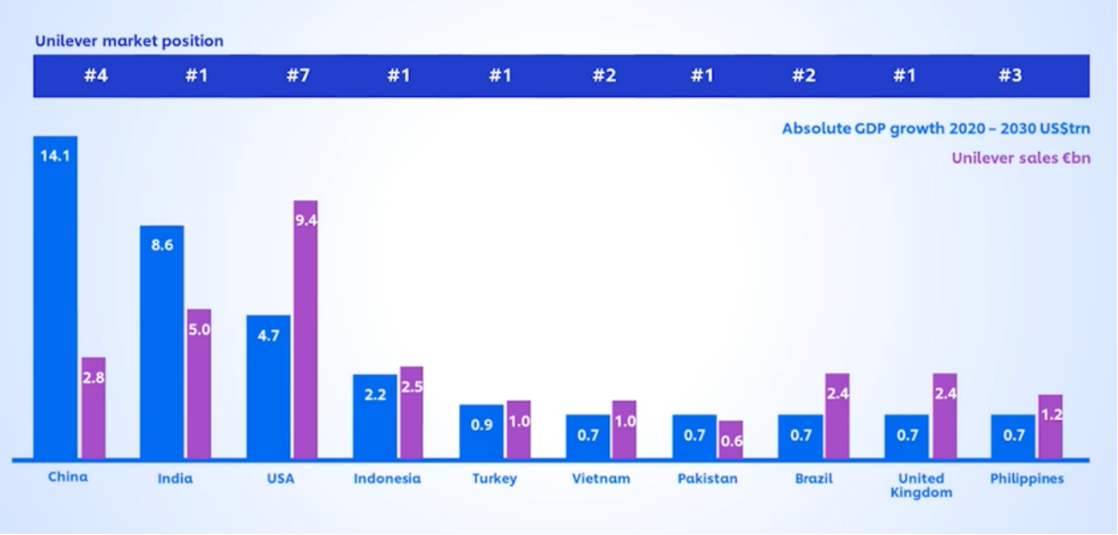
Day 1:

Companies presenting included Unilever which is held in the fund (UK listed; personal care, food and beauty), Church and Dwight (US listed: home care, heath and personal care), Mondelez (US listed: confectionary), Kraft Heinz (US listed: processed food) and Ingredion (US listed; ingredient supplier mainly of starches but also sugar and meat substitutes).

There were some common messages here to help frame the industry. Notwithstanding COVID distortions, the companies are achieving, and targeting for the future, revenue growth in the 3-5% range which is around the level of global GDP growth. These are mature entrenched companies so it is difficult to sustainably take market share. Also, the increased adverse demographics of the developed countries is offsetting the growth in developing economies. That said one of Warren Buffett's best investments; See's Candy, grew at this level and delivered great returns through sustained high return on capital and longevity.

Whilst e-commerce is fast growing it is still only around 5% of total sales for this subset although Unilever experienced rapid growth in the last 12 months to take their level to 9%. They have been working with Alibaba, JD.Com and Amazon but suggested they think they are behind competitors on these platforms. They were also the most expansive on digital investment and data gathering having set up 40 'social listening' data centres and 30 digital hubs world-wide. Their strongest markets though; India and Indonesia, are behind on e-commerce development.

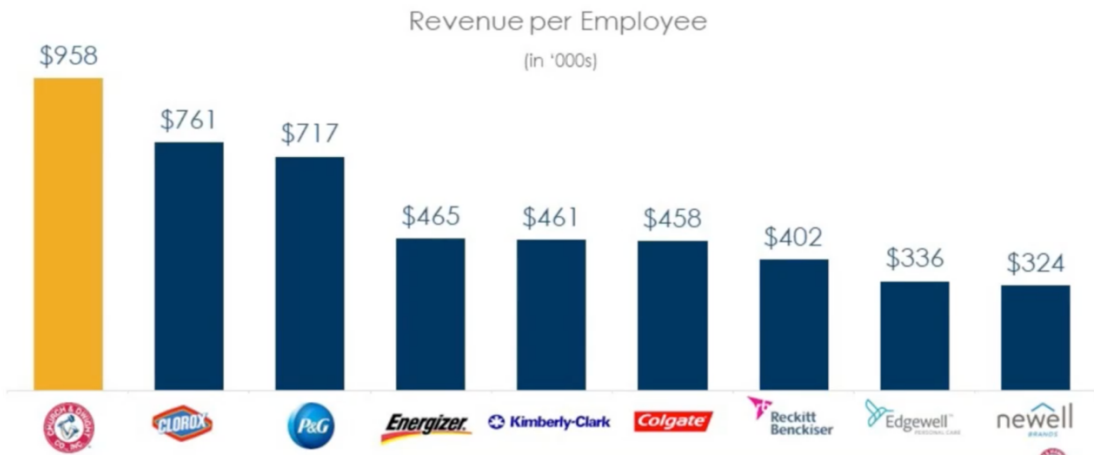
Unilever are particularly strong in India and Indonesia - the US and China are more competitive:



Source: Company presentation

Apart from Church and Dwight, who have a simple and effective business model, these particular companies are all struggling with certain more mundane aspects of their business.

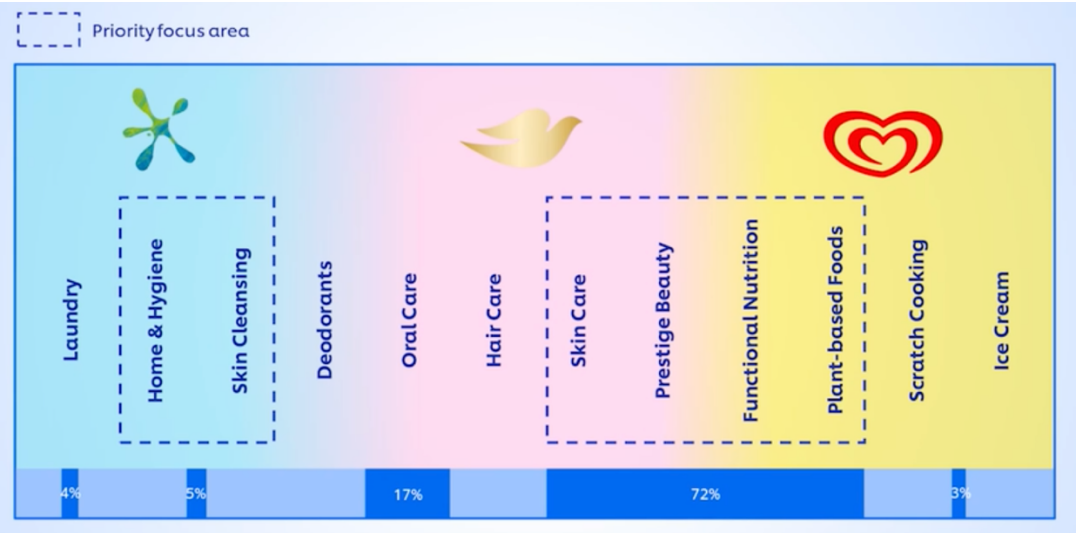
Church and Dwight's simple model results in best practice employee productivity:



Source: Company presentation

Kraft Heinz has huge brands but outdated products and had saddled itself with massive leverage. Mondelez was badly run for a decade and too acquisitive and is trying to refocus and Unilever has lost competitive strength against a resurgent Procter and Gamble (held) in the US whilst also trying to move more into personal care where there is strong competition from the likes of L'Oreal (held) and Estee Lauder.

Unilever's priority focus areas are competitive:



Source: Company presentation

Therefore much of their discussion dealt with the basics; simplification, restructuring costs and better cash flow. Whilst this is important, it risks distracting them from the longer-term issues I have described above. I sometimes wonder whether, like some fund managers, larger staples companies become over diversified. Mondelez, for example, has three very strong brands; Oreo, Cadbury and Milka but their strength is diluted by a tail of less good products that draw away attention and resource

The ingredients companies are an interesting group and some display high quality financial characteristics in a similar manner to their brand-led customers though for different reasons. These companies focus on the science and innovation that create a great taste or fragrance thereby contributing to a products success. The largest is Swiss listed Givaudan.

There are also suppliers of the basic ingredients that is more commoditised in nature, cyclical and lower return on capital. Ingredion, who presented, still has the majority of its business in the latter through the supply of basic starches but is trying to build in sugar substitutes – they acquired stevia producer Pure Circle - and more recently, plant-based meat substitutes. This appears to be a sensible way to allocate capital.