THE FMCG GLOBAL 50 2021

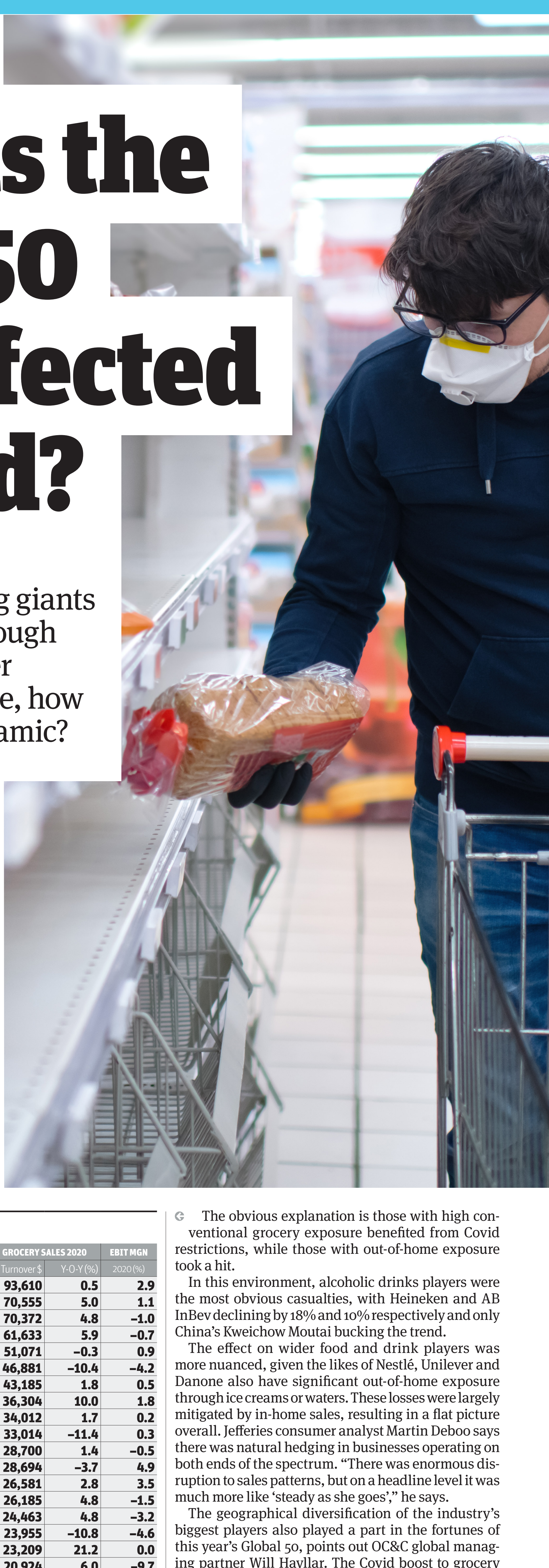
Highs and Lows

The Global 50's Covid reality

finance oc&c global 50

How has the Global 50 been affected by Covid?

Alec Mattinson



The world's 50 biggest fmcg giants have seen growth slow, though they have outpaced smaller players. As restrictions ease, how permanent is the new dynamic?

The pandemic may have provided a shot in the arm for grocery sales, but the world's largest fmcg companies have found themselves infected by the wider fallout from the global lockdowns.

So shows The Grocer/OC&C Global 50, with grocery revenues growing just 1.1% across the market's 50 biggest fmcg giants in 2020. That's down from 3.9% in 2019 and the lowest figure seen since the 0.5% rate of 2016.

Organic growth was a little better at 1.7% across those that split out like-for-like numbers, but that was still well down on the 3.8% of 2019 and 1.9% of 2016.

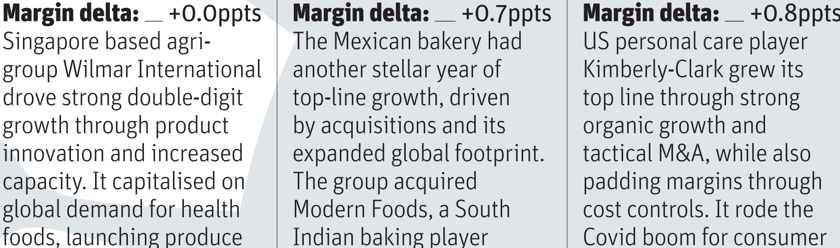
The picture that emerges is one of a widened chasm between winners and losers. Food and drink companies were up by 4.7% in the period (an improvement of 1.1 percentage points on 2019), while the beers & spirits sector slumped 8.7% (a 12.3 ppts reversal) and diversified companies fell 3.2% (down 11.4 ppts on 2019).

That has resulted in a higher churn than usual in the Global 50. Five companies changed their ranking by more than six places – led by Kweichow Moutai and Conagra, while LVMH, Kao and Molson Coors lost six or more places. There were also three new entrants: Tingyi, Imperial Tobacco and Saputo. Meanwhile, Shiseido, Carlsberg and J&J dropped out.

THE GLOBAL 50

RANK '20	RANK '19	COMPANY NAME	COUNTRY	GROCERY SALES 2020 Turnover $	GROCERY SALES 2020 Y-O-Y (%)	EBIT MGN 2020 (%)
1	1	Nestlé	Switzerland	93,610	0.5	2.9
2	2	Procter & Gamble	US	70,555	5.0	1.1
3	3	PepsiCo	US	70,372	4.8	–1.0
4	4	Unilever	UK/Netherlands	61,633	5.9	–0.7
5	6	JBS	Brazil	51,071	–0.3	0.9
6	5	AB InBev	Belgium	46,881	–10.4	–4.2
7	7	Tyson Foods	US	43,185	1.8	0.5
8	10	British American Tobacco	UK	36,304	10.0	1.8
9	9	L'Oréal	France	34,012	1.7	0.2
10	8	Coca-Cola Company	US	33,014	–11.4	0.3
11	12	Danone	France	28,700	1.4	–0.5
12	11	Phillip Morris International	US	28,694	–3.7	4.9
13	14	Mondelez	US	26,581	2.8	3.5
14	15	Kraft Heinz	US	26,185	4.8	–1.5
15	16	WH Group	China	24,463	4.8	–3.2
16	13	Heineken	Netherlands	23,955	–10.8	–4.6
17	20	Wilmar	Singapore	23,209	21.2	0.0
18	19	Altria Group	US	20,924	6.0	–9.7
19	23	Reckitt Benckiser	UK	19,708	20.3	–2.1
20	17	Suntory	Japan	19,349	–8.1	–1.1
21	18	Japan Tobacco	Japan	19,205	–3.8	–0.4
22	21	Asahi Breweries	Japan	18,293	–2.9	–3.1
23	22	General Mills	US	17,627	4.5	0.4
24	26	Grupo Bimbo	Mexico	16,637	9.7	0.7
25	24	Diageo	UK	16,552	1.3	–1.8
26	25	Colgate Palmolive	US	16,426	4.7	0.9
27	27	Kimberly-Clark	US	16,121	6.4	0.8
28	32	Yili Group	China	14,840	14.6	–0.8
29	30	Essity	Sweden	14,621	7.2	2.2
30	28	Estée Lauder	US	14,254	–3.7	–1.9
31	31	Kellogg Company	US	13,770	1.4	0.2
32	40	Kweichow Moutai	China	13,083	19.8	1.3
33	33	Marfrig Group	Brazil	12,893	4.3	4.6
34	35	Henkel	Germany	12,838	7.6	–3.4
35	29	LVMH	France	12,154	–12.5	–2.8
36	37	Mengniu Dairy	China	11,834	3.5	–1.9
37	39	Dr Pepper Snapple	US	11,618	4.5	–0.2
38	34	Kirin Breweries	Japan	11,527	–6.3	–1.7
39	41	FrieslandCampina	Netherlands	11,326	6.2	–0.5
40	38	Nippon Food Group	Japan	11,287	–0.3	–0.2
41	46	Arla Foods	Denmark	11,123	12.3	0.0
42	48	Conagra	US	11,054	15.9	0.3
43	36	Kao	Japan	10,566	–8.4	–1.4
44	53	Tingyi	China	10,419	18.5	2.1
45	51	Imperial Tobacco	UK	10,327	12.0	2.8
46	43	Pernod Ricard	France	10,265	–0.2	–1.4
47	56	Saputo	Canada	10,249	22.1	–0.0
48	44	Meiji Holdings	Japan	10,077	–0.5	0.2
49	42	Molson Coors	US	9,654	–8.7	0.4
50	49	Hormel Foods	US	9,608	1.2	–1.0

Notes: Turnover includes excise duty. EBIT margin excludes exceptional items. Year-on-year growth represents change in local currency sales.



The obvious explanation is those with high conventional grocery exposure benefited from Covid restrictions, while those with out-of-home exposure took a hit.

In this environment, alcoholic drinks players were the most obvious casualties, with Heineken and AB InBev declining by 18% and 10% respectively and only China's Kweichow Moutai bucking the trend.

The effect on wider food and drink players was more nuanced, given the likes of Nestlé, Unilever and Danone also have significant out-of-home exposure through ice creams or waters. These losses were largely mitigated by in-home sales, resulting in a flat picture overall. Jefferies consumer analyst Martin Deboo says there was natural hedging in businesses operating on both ends of the spectrum. "There was enormous disruption to sales patterns, but on a headline level it was much more like 'steady as she goes'," he says.

The geographical diversification of the industry's biggest players also played a part in the fortunes of this year's Global 50, points out OC&C global managing partner Will Hayllar. The Covid boost to grocery has been more prevalent in developed markets, he explains. Outside those, the grocery increase has been less significant and some of those more globalised categories have a high level of out-of-home consumption.

This 'winners and losers' picture is also evident in profit margins. Alcohol and diversified companies saw drops of 1.5 and 1.3 ppts respectively, while other areas saw mild margin improvement.

But as an aggregate, profit margins dropped by 0.3 ppts in 2020, with adjusted EBIT margins back down to 18.4% – reversing steady increases since 2016. Gross margins dropped more dramatically still, contracting by 1.6 ppts back to 45.5% – the lowest figure since 2015.

Hayllar argues the tightened margins reflect the effects of "losing out on typically higher margin out-of-home channels". He also points to the supply chain costs of managing Covid measures and staff shortages in the manufacturing and distribution process.

This impact was mitigated somewhat by reduced costs – most notably, a reduction in marketing spend. In 2020, all sectors except household and personal care cut marketing budgets as a proportion of revenues. Food and drink was the most significant with a 0.9 ppts reduction, reflecting the lack of advertising for products typically consumed out of home. There were also reductions in expenses related to travel restrictions.

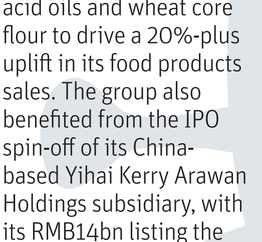
Changing dynamics

Some of these dynamics are naturally beginning to reset as restrictions ease, leisure and hospitality venues reopen and global travel resumes.

However, Bruno Monteyne, Bernstein senior analyst for European food and home & personal care, notes that this trend reversal is proving more gradual than some expected. "Covid is staying around longer and there are more doubts about how long it will take for all of us to go back to our old habits," he says.

Whatever happens on this front, the squeeze on margins seen during Covid is unlikely to go anywhere soon. The raw materials and commodities picture was relatively benign in 2020 as Covid recessions led to a drop in global inflation – but that is changing fast.

The top performers of the past year



Wilmar

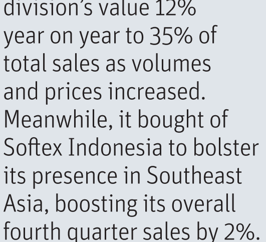
Sales: $23.2bn
Sales growth: 21.2%
Profit margin: 5%
Margin delta: +0.0ppts

Singapore based agri-group Wilmar International drove strong double-digit growth through product innovation and increased capacity. It capitalised on global demand for health foods, launching produce including zero-trans fatty acid oils and wheat core flour to drive a 20%-plus uplift in its food products sales. The group also benefited from the IPO spin-off of its China-based Yihai Kerry Arawan Holdings subsidiary, with its RMB14bn listing the largest on the Shenzhen exchange. Shares have almost doubled since its October 2020 IPO.

Grupo Bimbo

Sales: $16.6bn
Sales growth: 13.4%
Profit margin: 8%
Margin delta: +0.7ppts

The Mexican bakery had another stellar year of top-line growth, driven by acquisitions and its expanded global footprint. The group acquired Modern Foods, a South Indian baking player accounting for 35%-40% of the Indian bread market, while subsidiary Bimbo QSR entered Kazakhstan via a joint venture with Food Town, which supplies buns to McDonald's. The deals expanded its presence to 33 countries. The group also entered the sweet baked private label market with the acquisition of a Cerealto Siro Foods plant in Spain.



Kimberly-Clark

Sales: $16.1bn
Sales growth: 6.4%
Profit margin: 18%
Margin delta: +0.8ppts

US personal care player Kimberly-Clark grew its top line through strong organic growth and tactical M&A, while also padding margins through cost controls. It rode the Covid boom for consumer tissues, which grew the division's value 12% year on year to 35% of total sales as volumes and prices increased. Meanwhile, it bought of Softex Indonesia to bolster its presence in Southeast Asia, boosting its overall fourth quarter sales by 2%. Continued focus on the cost base drove $455m of savings since 2018, helping to boost margins.

Conagra

Sales: $11bn
Sales growth: 15.9%
Profit margin: 14%
Margin delta: +0.3ppts

US grocery supplier Conagra was one of the key names boosted by the boom in at-home consumption during the Covid period and a jump in demand for frozen products and snacks. Its grocery and snacks and frozen segments were up 18% and 22% year on year respectively, boosted by innovation and launches of plant-based frozen products and keto cakes. The top line was also bolstered by the incorporation of its 2018 Pinnacle Foods acquisition, which added 8% to its overall sales through well-known brands like Birds Eye.

Tingyi

Sales: $10.4bn
Sales growth: 10.2%
Profit margin: 9%
Margin delta: +2.1ppts

China's biggest noodle producer enjoyed strong growth, driven by NPD and favourable market conditions for instant noodles. Tingyi achieved 17% growth in the category against the market average of 4.7% as it introduced new products and packaging, particularly focused on younger consumers. The producer launched sugar-free ranges and refreshed its brand image through youth-focused marketing. It also invested heavily in online, while promoting its Line View tool to improve manufacturing efficiencies and cut production costs.

As economic recovery gathers pace, inflation is expected to rise to around 4% in 2021 and at a far faster rate for key underlying commodities, such as transport, petrochemicals, plastics and food ingredients (p31).

This summer a number of Global 50 players, including Unilever, Nestlé, Heineken and Reckitt Benckiser, all warned cost input hikes would put the squeeze on margins in the second half of this year.

Hayllar calls the incoming wave of inflation "significant, but not unprecedented", highlighting bigger inflationary spikes in 2011 and 2008. Nonetheless, it represents a stark reversal of benign global inflationary conditions since 2011 and is, according to Deboo, "about as dramatic as anything we've seen".

The spate of margin downgrades suggests input inflation is already hitting the bottom line, but the full effects are unlikely to be felt until at least 2022.

Giulio Lombardi, head of EMEA food, beverages, tobacco and consumer at Fitch Ratings, says companies will be significantly hedged against these major commodity movements in the short term, but will begin to feel the full weight of inflation when these hedges run out by the end of 2021. At that point, "companies will need to decide whether to try to pass on cost increases through pricing or to absorb a little margin pressure".

> **"In the short term, suppliers are hurting as they have higher costs that they haven't been able to pass on yet"**

And while inflation can be hedged in areas like petrol or corn, Monteyne suggests wider inflationary pressures in plastics and transportation are harder to mitigate. That means suppliers are already feeling the pinch in some areas.

"Some of these cost increases have hit suppliers immediately, but at the same time you have to wait on average six to nine months before you see retailers pass on some of that inflation," he says. "In the short term, suppliers are hurting as they have higher costs that they haven't been able to pass on yet."

The better news for suppliers is their record of passing on inflation is strong. OC&C found that in the UK they were able to pass on £5.6bn of the £5.7bn of commodity-driven inflation to retailers in 2007/08, £3bn of the £3.3bn in 2011 and £1.4bn of the £1.7bn in 2017-18.

"The conditions for passing pricing through are relatively favourable to the big brand owners," Hayllar argues. "Partly because the factors driving inflation are so well understood in terms of real underlying cost inflation, and in a world where real availability issues are still impacting retailers who have no desire to get into trading disputes to disrupt supplies."

Deboo agrees any margin hit is likely to be mitigated over the longer term. "There are lead and lag effects,

Covid cuts value of M&A deals

Global 50 M&A levels were weak during Covid – the lowest level for well over a decade. Deals were worth $22bn from 45 deals, down from 2019's $45bn from 48 deals.

Activity was led by PepsiCo's $3.9bn deal for Rockstar, while Nestlé made a $1.7bn bio-pharma bet with Aimmune Therapeutics.

But a reduction in the average size of deals (from $0.94bn to $0.49bn) pointed to a market highly skewed towards smaller deals, targeting growth and product diversification.

In terms of divestments, there were two deals worth over $3bn: Kraft Heinz's cheese business sale and AB InBev's metal container plants. Most were smaller and tactical, led by five Nestlé deals to shed low growth and non-core assets.

Overall divestments numbers were flat at 16, though values were down 71%, from $28bn to $8bn.

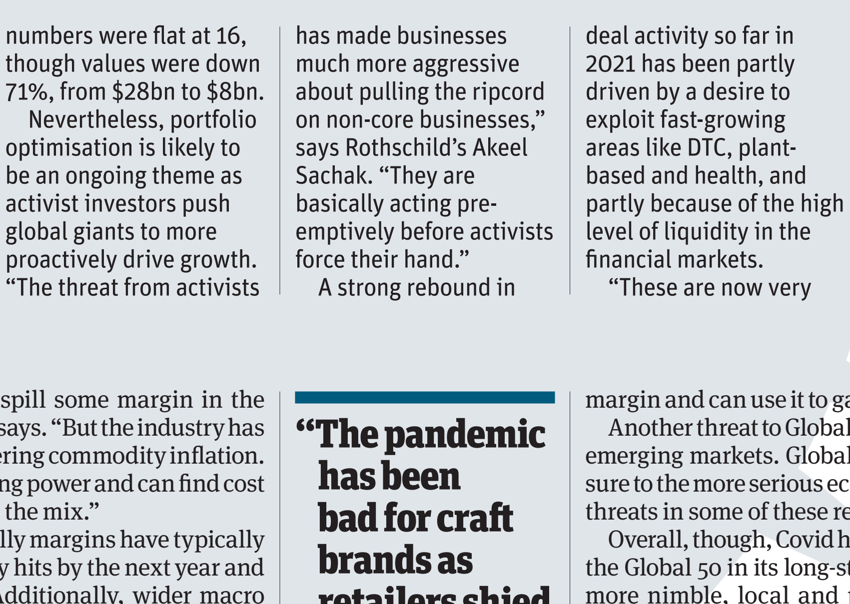
Nevertheless, portfolio optimisation is likely to be an ongoing theme as activist investors push global giants to more proactively drive growth. "The threat from activists has made businesses much more aggressive about pulling the ripcord on non-core businesses," says Rothschild's Akeel Sachak. "They are basically acting pre-emptively before activists force their hand."

A strong rebound in deal activity so far in 2021 has been partly driven by a desire to exploit fast-growing areas like DTC, plant-based and health, and partly because of the high level of liquidity in the financial markets.

"These are now very fertile conditions for M&A," Hayllar says. "We are seeing the market catching up by pulling the trigger on activity deferred from 2020, but also because of the conditions in place due to the structural changes in the market and the available cash to fuel it."

When it comes to mega-deals and large-scale consolidation, things are less certain. Hayllar points to potential opportunities for consolidation plays in growth areas heightened by Covid that remain fragmented, such as nutritional supplements and health & beauty.

But Deboo thinks big ticket supplier M&A will remain out of favour. Contemporary fashion favours better returns from paying large multiples for small, high-growth assets, rather than lower multiples for mature ones.



M&A activity this year was led by PepsiCo's £3.9bn deal for energy drink maker Rockstar

so companies usually spill some margin in the early stages of the cycle," he says. "But the industry has a good track record of recovering commodity inflation. It retains a great deal of pricing power and can find cost savings elsewhere or richen the mix."

OC&C notes that historically margins have typically rebounded from inflationary hits by the next year and moved back into growth. Additionally, wider macro inflation is also likely to feed into higher wages in many markets, while the lack of travel and discretionary spend opportunities during Covid has meant consumers potentially have more available cash to spend on branded consumer goods. "The evidence so far is that consumers will be able to bear those inflationary cost increases," Hayllar says.

At the same time, inflation could also lead to market share pressures from private label in developed economies as consumer shopping bills rise. That's particularly true in more commoditised categories such as household goods or food staples like sauces or yoghurts, according to Bernstein's Monteyne.

"This year retailers are going to be in decline," he says. "And retailers hate shrinking as it's not good for their cost structure, so one thing they try to do is lean more heavily on private label as they make more margin and can use it to gain leverage with suppliers."

> **"The pandemic has been bad for craft brands as retailers shied away from the complexity of dealing with niche suppliers"**

Another threat to Global 50 growth is the situation in emerging markets. Global fmcg has significant exposure to the more serious economic pressures and Covid threats in some of these regions.

Overall, though, Covid has largely been a tailwind for the Global 50 in its long-standing battle with smaller, more nimble, local and potentially on-trend insurgents. Having made up ground in recent years, largely through acquisition, the trend of share loss against insurgents was further reversed in 2020.

OC&C found multinational share change was improved in food, beauty and cosmetics last year, compared with the 2015-19 period, with only large personal care players losing further share.

"The pandemic has been bad for craft brands as the retailers shied away from the complexity of dealing with niche suppliers," says Akeel Sachak, Rothschild & Co's global head of consumer.

Global players were able to leverage the benefits of scale to overcome supply chain disruption, while smaller players struggled by comparison – particularly as they tend to outsource parts of the process. That led to some smaller players being squeezed in rationalisations, as retailers prioritised supply reliability over choice. Additionally, consumers came back to trusted, established brands during the crisis.

"If anything, Covid made life a bit easier for the big brands as from a competition point of view they had a free pass," Monteyne says. Still, he doubts that will persist. "Those benefits will unwind and it will go back to what it is always about: innovating, exciting consumers, coming up with new ideas and doing something fundamentally better to earn your price premium."

The online habit

That's particularly true given that global players are facing fresh competition from small suppliers in one rapidly growing area: online. The pandemic has made the channel even more crucial – with online penetration rising by 8 ppts in the UK last year, 5 ppts in the US and 3 ppts in Western Europe.

Although this trend is likely to slow, 86% of consumers say they are likely to continue new online shopping habits, according to OC&C's report.

This fundamental shift will benefit those players that have invested heavily in online capabilities and those with greater online exposure, such as L'Oréal (25% of sales) and P&G (15%). "Initially, online favoured smaller players who were faster to adopt the tools needed to achieve success in online channels, but the majority of big players have invested very heavily in the last decade and frankly are now in a good position to manage that channel migration," Hayllar says.

Major players continue to make tentative pushes into the direct-to-consumer space – with PepsiCo launching a DTC website during the crisis and Coca-Cola scaling up its home delivery platform in Latin America.

However, much of the push in digital is via M&A – with Colgate buying vegan toothpaste and mouthwash player Hello Products, Danone buying DTC consumer probiotics and gut health company Sun Genomics and Nestlé acquiring UK recipe kit player SimplyCook.

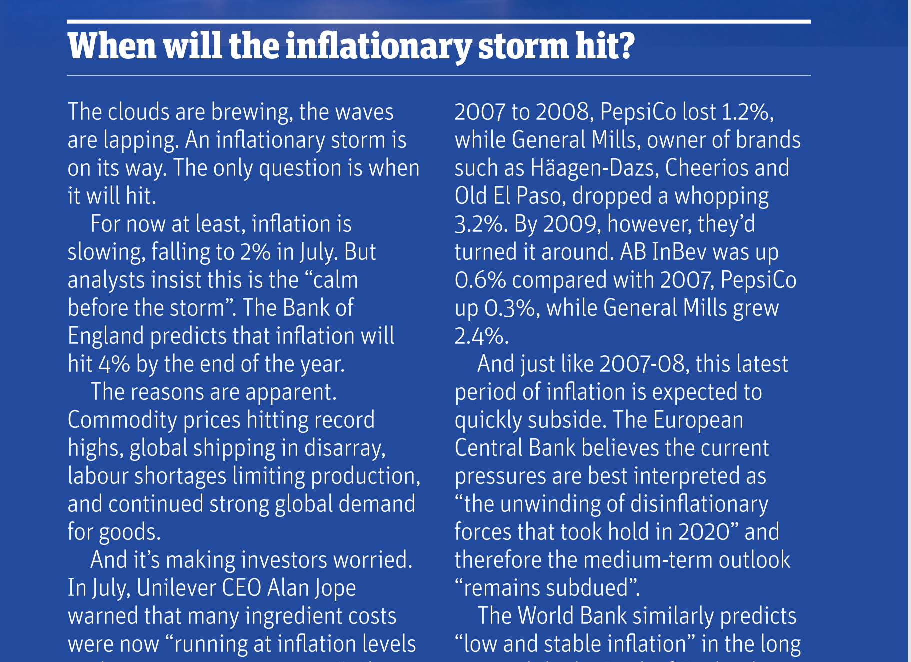
These acquisitions have typified what M&A activity there was in 2020 (see box, left), with Fitch's Lombardi noting particular focus on "acquiring innovation in developed markets". It's an example of how M&A activity has bounced back in 2021 as the industry comes out of Covid, led by Nestlé's $5.8bn acquisition of supplements player The Bountiful Company.

The UK alone has seen a surge in private equity-backed dealmaking so far this year – with two of the big four supermarkets subject to multibillion-pound bids and Bain Capital's £1.5bn buyout of Valeo Foods.

That hunger for grocery assets has also provided opportunities to divest assets to PE – such as PepsiCo's sale of Tropicana and Unilever's expected tea division sale – and also points to the enduring strength of the global grocery sector as the economy recovers.

Altogether, the Covid period – contrary to some suggestions – wasn't a land of milk and honey for global fmcg suppliers. The industry suffered sales slowdowns and margin contractions reflecting wider economic chaos. Now, the industry must face and mitigate a wave of inflation.

But the experience of 2020 shows the global fmcg industry deserves its reputation as a rock in stormy seas. And the scale of the multinational giants will help them navigate the waves better than most.



When will the inflationary storm hit?

The clouds are brewing, the waves are lapping. An inflationary storm is on its way. The only question is when it will hit.

For now at least, inflation is slowing, falling to 2% in July. But analysts insist this is the "calm before the storm". The Bank of England predicts that inflation will hit 4% by the end of the year.

The reasons are apparent. Commodity prices hitting record highs, global shipping in disarray, labour shortages limiting production, and continued strong global demand for goods.

And it's making investors worried. In July, Unilever CEO Alan Jope warned that many ingredient costs were now "running at inflation levels we have not seen since 2011". Along with Nestlé and Danone, Unilever has issued profit warnings as a result. Danone's gross margin could fall by up to 2.16%, according to Jefferies.

If historical precedents can offer a snapshot of the future, then here at least, companies will find some hope. The financial crash of 2007-08 led to equal, if not greater, inflationary pressure on food and drink and in many cases had a similar effect on profit margins.

AB InBev saw profits fall 1.7% from 2007 to 2008, PepsiCo lost 1.2%, while General Mills, owner of brands such as Häagen-Dazs, Cheerios and Old El Paso, dropped a whopping 3.2%. By 2009, however, they'd turned it around. AB InBev was up 0.6% compared with 2007, PepsiCo up 0.3%, while General Mills grew 2.4%.

And just like 2007-08, this latest period of inflation is expected to quickly subside. The European Central Bank believes the current pressures are best interpreted as "the unwinding of disinflationary forces that took hold in 2020" and therefore the medium-term outlook "remains subdued".

The World Bank similarly predicts "low and stable inflation" in the long term, while the Bank of England expects inflation to return to 2% in about two years. While it does last, shoppers are likely to be worst hit. 2007's bout of inflation saw producers and retailers pass on all of £5.7bn inflation costs to customers, while in 2011 it was 60%, OC&C analysis shows.

In 2017-18, retailers even took the opportunity to boost their margins by 0.3% when commodity prices rose. The public will hope they won't be so bold as to try that tactic again.

Last year we started to see the first effects of COVID-19 on the Global 50 Consumer Goods giants and for some it was alarming – companies exposed to Chinese consumer demand and Travel Retail were reporting steep declines for their Q1 2020.

Now more than one year into this disruption, we can see its effect more clearly and although it has not been an easy year, with overall growth subdued versus the usual Global 50 standards, it has seen the large players reclaiming some of their turf from insurgent smaller brands. The divide between winners and losers is stark, with players exposed to the right areas (e.g. at-home food & drink consumption) surging whilst those reliant on out of home and social consumption have taken big hits. The last year has also fast forwarded some profound changes which were already underway – particularly around e-commerce and awareness on sustainability – and are now here to stay.

Finally the uncertainty which has marked the past 18 months has created spikes in demand and disruption to supply chains, driving a resurgence of commodity inflation which will put pressure on Global 50 profitability as they race to recover pricing in time.

This turbulence has undoubtedly created daunting challenges for the Global 50 but also opened opportunities to fundamentally rethink their proposition and adapt to evolving consumer needs.

Now is the time to pivot and build a future-proof business. Are you positioned to be one of the winners?

- Have you evolved your portfolio to capitalise on long term changes to consumer needs?
- Are you strongly present in the channels that consumers have gravitated towards?
- Are you ready to digest the raw material shock and defend your position?
- Can you capitalise on competitors who are exposed and struggling to adapt?
- Can you use your balance sheet to fund M&A that step changes your competitive position and helps you address pockets of growth and/or new capabilities required to win?

If you answered no to any of these questions or if you would like to find out more about the OC&C FMCG Global 50, our team would be delighted to hear from you.

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