TIED UP

The FMCG Global 50 2017

OC&C Strategy Consultants

In 2016 FMCG M&A plummeted, down $176bn on the previous year, as political uncertainty depressed deal-making in the sector. Overall revenue growth for the Global 50 turned negative for the first time in 13 years (-0.7%). Underlying organic volume growth also remained at near record lows, at just 0.7%, up slightly from 2015's 0.5%, but still below global population growth of 1.1%. And this at a time when there is increasing pressure from activist investors to boost margins.

M&A UNDER PRESSURE

Our annual Global 50 report reveals the big themes shaping the industry. Now in its 15th year, it assesses the performance of the world's 50 largest FMCG businesses – the likes of Nestle, P&G, Diageo and PepsiCo – ranked on revenues. Information is taken from the latest annual report of each business and turnover is stated in US dollars, but the growth rates quoted are those in the local currency in which each company reports. According to our 15th Global 50 report, M&A fell sharply from $226bn in 2015 to $50bn in 2016.

With FMCG companies struggling to find growth, there's more reason than ever for M&A activity – be that acquisitions to access growth segments or consolidation to drive profitability. However, uncertainty about the consequences of Brexit – along with populist parties gaining ground across Europe plus the uncertainty generated by the US presidential election – depressed deal-making in the sector.

The decline in 2016 came after a bumper year for M&A in 2015 and brings deal value to its lowest level since 2011, less than half the ten-year average (average annual deal value between 2006 – 2015: $108bn).

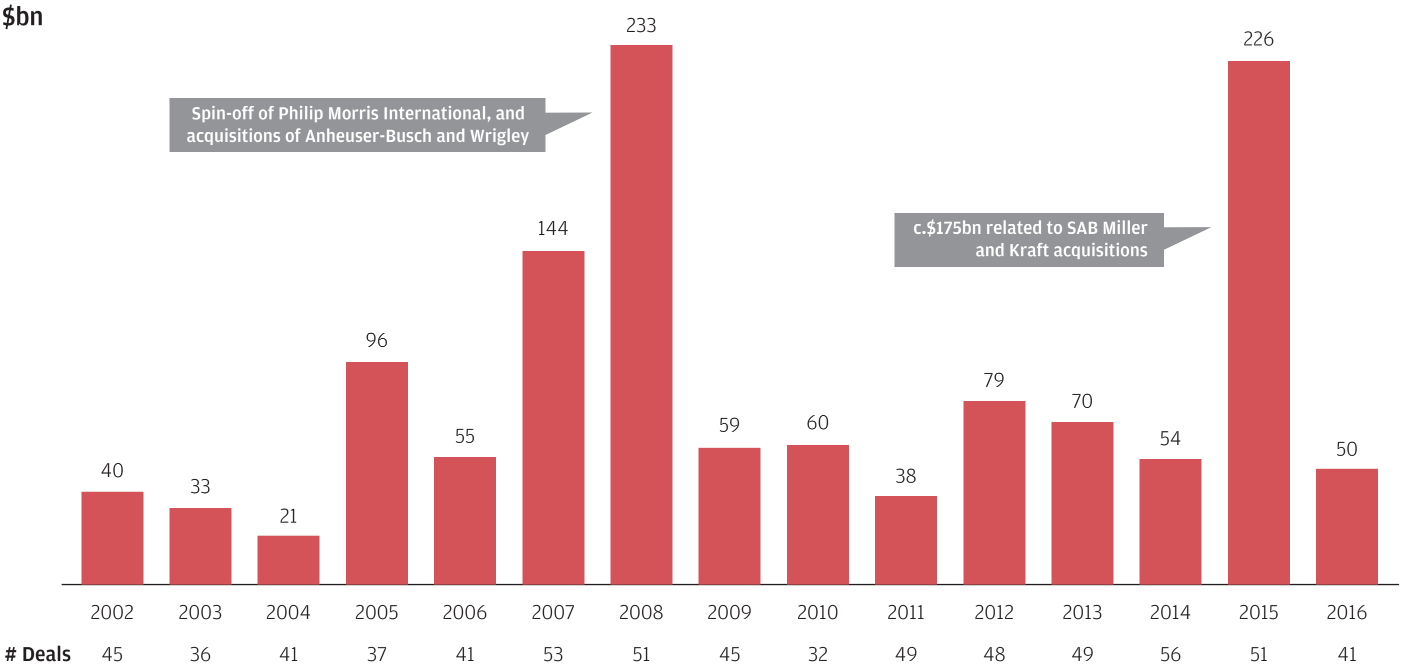
However, we're already seeing some recovery in the first half of 2017, with M&A beginning to recover across the sector as businesses adjust to the new political norms. Between January and May 2017, ten deals were announced, with a combined value of $87bn. Although one of the biggest potential deals – Kraft Heinz's failed takeover of Unilever – was spectacularly scuppered earlier this year.

"POLITICAL UNCERTAINTY DRIVES CONSUMER GOODS M&A TO LOWEST LEVEL SINCE 2011"

FIGURE 1:

The number and value of deals for the Global 50 declined significantly in 2016

Value of deals involving the Global 50[1], 2002-16[2]



[1] Undisclosed value deals are not considered

[2] Dates refer to the deal announcement date. Deals that have been announced in 2016 are considered for analysis.

Source: Mergermarket, Trade reports, OC&C analysis

STUCK IN THE MUD

The Global 50 saw organic growth slump further in 2016, down from 3.4% to 2.6%, with overall revenue growth turning negative for the first time since 2003. The top-50 consumer goods giants lost eight percentage points of sales growth in just five years (from +7.3% in 2011 to -0.7% in 2016).

Digital insurgents

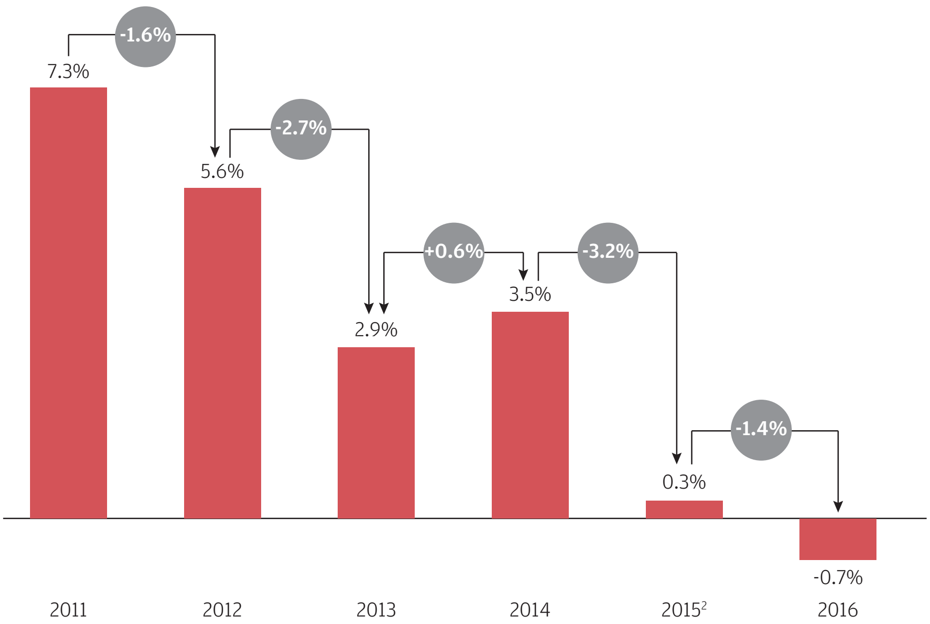
These companies are facing increased competition from a new generation of smaller insurgent brands that have differentiated products appealing to particular segments of consumers and are using digital technologies to target and engage with those consumers. These players are chipping away at the big brand owners from lots of different directions and capturing much of the growth in the industry. Good examples include Fever Tree, which created a new tier of premium tonic water and has grown very rapidly across the world, delivering stellar returns for investors who got into the business at an early stage.

> **"ALTHOUGH MARKET GROWTH REMAINS HARD TO COME BY, THERE ARE PLAYERS WITHIN THE GLOBAL 50 THAT ARE MANAGING TO DELIVER SUPERIOR ORGANIC GROWTH"**

FIGURE 2:

Revenue growth of the Global 50 was slightly negative in 2016, continuing the downward trend since 2011

Revenue growth of FMCG Top 50, 2011 – 16[1]



[1] Growth of grocery sales excluding excise in local currency weighted by grocery sales excluding excise in $

[2] Revenues figures for 2015 adjusted based on changes in accounting policy and to normalize the period of reporting for Kraft Heinz used in last year's analysis from 15 months (January 1 – March 31) to 12 months (January 1 – December 31)

Source: OC&C Global 50, company financial reports

While the Global 50 haven't broken the growth deadlock, they have made progress on profitability. Both gross and net profit margins grew in 2016, with headline net profit up by 2.2 percentage points, increasing to 18.8% from 16.6% the previous year (although most of this was due to exceptional gains at Altria and Reynolds) and the underlying net profit margin increase was more modest (up 0.5% to 17.0%).

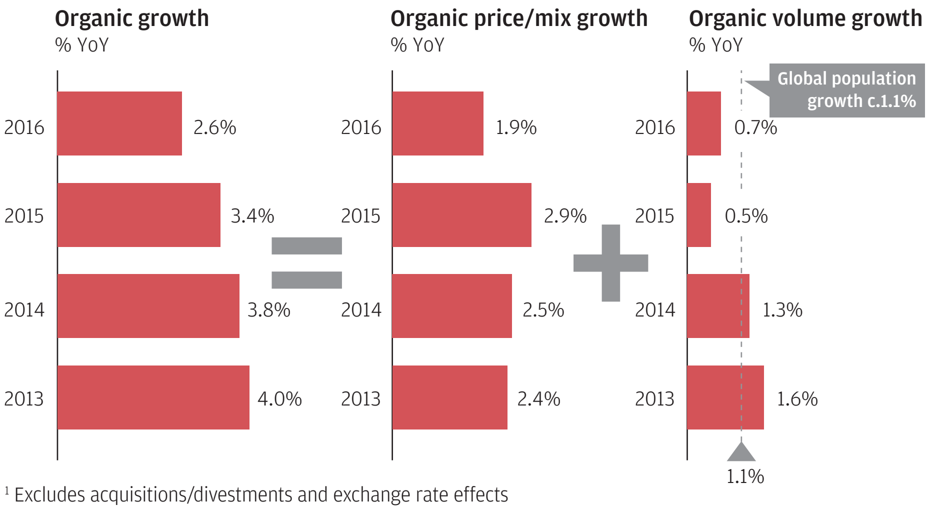
Despite the emphasis on cost-cutting programmes, this increase in profitability was driven largely by favourable commodity prices, rather than a reduction in overheads (which actually grew as a % of sales) or the impact of Zero-Based Budgeting (ZBB).

FIGURE 3:

Organic growth slowed ... owing to a reduction in price/mix growth and continued low volume growth

Organic growth[1] breakdown 2013-2016

Sample of 13 out of Global 50[2]



[1] Excludes acquisitions/divestments and exchange rate effects

[2] Weighted average of organic growth of 13 Global 50 companies that have reported organic growth for the last 4 years and stated the effects of price and volume, weights are based on grocery sales in that year in $

Source: Annual reports, OC&C analysis

The 3G model

An increase in profit margins poses the question as to whether this is a sign of the impact 3G is having on the global FMCG industry, having successfully boosted margins at ABI and Heinz by eight and six percentage points, respectively, in the years after acquiring them. Ripple effects are clearly visible in the number of Global 50 businesses adopting 3G's favoured ZBB method to boost profits but, with mixed results across the ten other Global 50 firms that state they have adopted ZBB, and five seeing margins decline in the past year, the sustainable success of 3G's model is still open to question.

PREMIUM PAYS

A number of leading players, including PepsiCo, Nestle and Unilever have invested in new brands and products to grow their premium presence in existing categories.

One example is Unilever, which has made multiple acquisitions of small premium players in recent years (e.g. T2, Talenti, GROM, REN, Murad and Kate Somerville). Others are realising material growth through alternative channels, including convenience, food service and specialty stores.

Premium brands typically grow ahead of the market, with players like Diageo building up their premium brand portfolios, for example by acquiring Casamigos tequila from George Clooney for $1bn.

"PREMIUM BRANDS TYPICALLY GROW AHEAD OF THE MARKET"

WINNING STRATEGIES

The landscape continues to look challenging for consumer goods companies, but there are winning strategies out there.

By focusing on e-commerce, premiumisation and tapping into consumer trends, such as healthy living, we've seen industry leaders grow. Early adopters should redouble their efforts in these areas to kick-start growth, and those slower off the mark should incorporate these aspects into their business strategies as soon as possible or risk being left behind.

Sector leaders such as PepsiCo, Unilever, and Nestle are finding superior organic revenue growth through the following strategies:

- Actively pursuing e-commerce opportunities has resulted in Unilever, Mondelez and Nestle growing their e-commerce revenues by 30-50% in 2016. Despite e-commerce still contributing a relatively low share of revenue, these companies show that it can provide 1-2 percentage points of overall organic growth.
- As already mentioned, premiumisation strategies, both organic and inorganic, have also proved effective. Diageo, for instance, has launched new brands and products to grow its premium presence in existing categories as well as making premium acquisitions.
- Tapping into the healthy living trend among consumers has generated good results. Now, sales of Innocent make up 1% of Coca-Cola's global sales. Although still relatively small, this has the potential to make a big difference to the growth of the business. Likewise, just 12% of PepsiCo's revenue now comes from Pepsi, while 'Everyday Nutrition' generates 25% and 'Guilt-Free' 45% of revenues, underpinning PepsiCo's superior organic growth in the past year.

> **"BY FOCUSING ON E-COMMERCE, PREMIUMISATION AND TAPPING INTO CONSUMER TRENDS, SUCH AS HEALTHY LIVING, WE'VE SEEN INDUSTRY LEADERS GROW."**

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OC&C and The Grocer's Global 50 Top 10 in 2016

1. Nestlé
2. P&G
3. PEPSICO
4. Unilever
5. JBS
6. ABInBev
7. The Coca-Cola Company
8. Tyson
9. L'ORÉAL
10. PHILIP MORRIS INTERNATIONAL

2016 ranking of the Global 50

Rank	Change 2016/15		Company	Country	Grocery Sales[2]		EBIT margin[1]		Return on Capital Employed	
					In $m in 2016	% change in local currency sales '16 vs 15'	2016	2015	2016	2015
1	▶	-	Nestle Ag	Switzerland	$90,832	1%	15.6%	15.1%	14.6%	14.9%
2	▶	-	Procter & Gamble	US	$64,877	-8%	21.1%	19.1%	14%	13.1%
3	▶	-	Pepsico	US	$62,799	0%	15.6%	15.4%	16.3%	17.3%
4	▶	-	Unilever	UK/Netherlands	$58,340	-1%	15.1%	14.3%	22%	23.5%
5	▶	-	JBS	Brazil	$48,623	7%	4%	5.6%	7.9%	9.1%
6	▲	1	Ab Inbev	Belgium	$45,517	4%	28.3%	31.9%	5.8%	13%
7	▼	-1	Coca-Cola Company	US	$41,863	-5%	19.7%	22.2%	10.7%	12.5%
8	▶	-	Tyson Foods	US	$36,881	-11%	7.7%	5.3%	14.4%	10.9%
9	▲	1	L'Oréal	France	$27,576	3%	16.7%	18%	16.2%	18%
10	▲	2	Phillip Moris International	US	$26,685	0%	40.9%	40%	52.4%	55.2%
11	▶	-	Kraft Heinz	US	$26,487	-3%	23.2%	24.7%	5.5%	4.3%
12	▼	-3	Mondelez	US	$25,923	-13%	11.2%	7%	6%	4.1%
13	▲	2	Heineken Holding	Netherlands	$23,012	1%	13.8%	13.8%	9.7%	9.6%
14	▶	-	Danone	France	$22,496	-2%	13.8%	13.3%	8.5%	12%
15	▼	-2	Archer Daniels Midland	US	$22,152	-12%	3.2%	3.7%	7.5%	9.4%
16	▲	1	Suntory	Japan	$22,032	0%	6.5%	5.7%	4.7%	4%
17	▲	1	WH Group	China	$20,242	6%	8.8%	7.2%	17.2%	13.1%
18	▼	-2	British American Tobacco Plc	UK	$20,000	13%	46.7%	44.2%	24.1%	25.6%
19	▶	-	Altria Group	US	$19,241	2%	46.2%	44.6%	25.2%	40.3%
20	▶	-	Japan Tobacco	Japan	$18,878	-5%	24.4%	24.4%	16.1%	18.5%
21	▶	-	General Mills	US	$16,563	-6%	16.9%	15.3%	16.2%	15.2%
22	▲	5	Kirin Breweries	Japan	$16,403	-6%	8.5%	7.7%	8.9%	8.4%
23	▲	5	Asahi Breweries	Japan	$15,336	1%	9%	6.9%	9.9%	8.6%
24	▶	-	Colgate Palmolive	US	$15,195	-5%	25.3%	24.2%	43.4%	44.5%
25	▲	1	Kimberly Clark	US	$15,013	-2%	18.9%	9.5%	40.4%	19.7%
26	▼	-4	Sabmiller Plc	UK	$14,895	-10%	30.7%	33.1%	12%	14.%
27	▼	-4	Diageo	UK	$14,216	-3%	30.4%	30.9%	14.2%	15.8%
28	▼	-3	Conagra	US	$14,134	-11%	-1.2%	2.1%	-1.2%	2.3%
29	▶	-	Grupo Bimbo	Mexico	$13,525	15%	7.5%	6.5%	12%	11.1%
30	▶	-	Reckitt Benckiser	UK	$13,411	11%	24.4%	25.3%	18.6%	20.3%
31	▶	-	Johnson & Johnson	US	$13,307	-1%	28%	28%	18.3%	18.9%
32	▲	3	Reynolds American Inc	US	$12,503	17%	43.6%	35.3%	12.2%	8.4%
33	▶	-	SCA	Sweden	$11,832	3%	9.6%	9.5%	8.8%	9.1%
34	▼	-2	Kellogg Company	US	$11,800	-4%	10.2%	7.4%	12.5%	9.1%
35	▲	4	Nippon Meat Packers	Japan	$11,440	2%	2.7%	3.8%	6.4%	9.2%
36	▲	1	Kao	Japan	$11,247	0%	12.9%	10.9%	22.7%	19.5%
37	▼	-3	Estee Lauder Companies (The)	US	$11,190	4%	14.3%	14.9%	23.4%	26.2%
38	▲	3	Henkel	Germany	$10,661	7%	14.7%	14.5%	13.9%	17%
39	▲	3	Imperial Tobacco	UK	$9,972	14%	16%	15.9%	10.9%	9.6%
40	▼	-4	LVMH	France	$9,837	5%	16.4%	15.8%	12.9%	12%
41	▼	-1	Royal Frieslandcampina	Netherlands	$9,828	-2%	5.3%	5.3%	10.4%	11.7%
42	▲	1	Brasil Foods	Brazil	$9,718	5%	5.4%	13.1%	5.6%	14%
43	▲	2	Pernod Ricard Sa	France	$9,609	1%	24.1%	18.6%	7.9%	6.1%
44	▲	2	Hormel Foods	US	$9,523	3%	14%	11.6%	27.7%	23.3%
45	▼	-1	Carlsberg	Denmark	$9,307	-4%	13.2%	12.9%	8.8%	9.3%
46	▼	-8	Arla Foods A.m.b.a	Denmark	$9,000	-5%	4%	3.9%	8.6%	8 %
47	▲	4	Yamazaki Baking	Japan	$8,943	2%	3.1%	2.5%	7.8%	6.2%
48	▲	1	Bunge Limited	Bermuda	$8,506	2%	2.7%	3%	8.7%	10.2%
49	▼	-2	Tingyi	China	$8,280	-8%	5.3%	5.9%	7.4%	8.1%
50	▶	-	Campbell	US	$7,961	-1%	12.1%	13.5%	14.8%	16.1%

[1] EBIT after earnings from associates and other exceptional items

[2] Grocery sales exclude excise duty payments

Source: Annual reports, 10K, OC&C analysis

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