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Finding the leaders in the worldwide consumer market

Recently returning from CAGNY, the biggest consumer staples conference in the US, Investment Analyst Lucina Martin shares key learnings from some of the world's largest companies and what they are focussing on to drive future growth. Lucina also discusses what factors will differentiate the high-quality businesses from the rest.

What were the key learnings from CAGNY - a flagship conference in the US for the consumer staples sector?

It was a really fantastic experience and we learnt a lot about the consumer staples sector. There were important insights and implications for how the Global Fund is positioned in the sector and for some of the companies that we're selecting out of that sector and then how we think about quality in general. In terms of the conference, it was held in Florida in the US, and that's where 30 of the largest consumer staples brands come together from all over the world. Some companies in the global portfolio were present, L'Oreal and Colgate-Palmolive and others like Coca-Cola. Each of those companies bring their CEOs, their CFOs and head of division. It's a great opportunity for us to engage with these companies. We spoke a lot about some of the short-term risks that they're encountering and how they're addressing these. Importantly, we discussed the longer term as well. We discussed strategies and investments they're making today to improve their competitive advantages and bolster their brands. Like any good consumer staples conference, there were plenty of opportunities for us to try their latest snack brands, beverage products, skincare products, you name it, it was all there.

We have all noticed the price increases at the shops lately. What will be the focus for companies to drive growth going forward and were there any key learnings from the conference on this?

We've been through a really volatile period for the sector, we've seen double digit pricing growth and positive volumes. Now that the inflation cycle has played out, pricing has reverted to a low single digit level but unfortunately volumes have turned negative. Growth in the sector has been much harder to come by and companies need to pedal really hard to get volumes to accelerate again. We heard a lot about this at the conference. There is one thing to know about the consumer staples sector – volume growth is the hallmark of a company that's high quality and executing. Those companies know their consumer well and they have the data to support it. They have the teams to create new products to address consumer needs and they can market that effectively to the consumer. It's that combination of factors that we're looking for and it was a key focus at the conference as well. Firstly, thinking about consumer data and analytics, after listening to many presentations across the sector from high quality to low quality companies, we noticed that those high quality companies have a scale advantage here. They know the consumer best in those categories, they have the financial firepower to be ahead of technology and really leverage that to their advantage. Those companies are in a winning position in comparison to those smaller or lower quality companies in the sector. In terms of innovation, bringing a buzz and excitement to the category and really engaging that consumer, companies are in a much better position to do this than what they have been in the past. They've been able to replenish their innovation pipelines because the supply chain is now in a less volatile position and we're going to see lots of new products coming to market over the next few months.

Will we continue to see companies spend and invest more in their brands?

Communicating to the consumer that marketing piece, we believe there's going to be differentiation between a company's willingness and their ability to invest in marketing. If we take an example like L'Oreal, which is in the Magellan Global Fund, they've been able to grow revenues really consistently over the last three years and reinvest in their marketing. L'Oreal's marketing's up nearly 50% since 2019 levels, that's quite material. They have the financial firepower to continue to do that and really engage those consumers at the largest events. These companies are paying upwards of $10 million for just a thirty second or minute Ad campaign, sometimes at the Superbowl as an example. We saw recently, L'Oreal's campaign with actor Michael Cera and its skincare brand CeraVe. It was a successful example of viral marketing. Overall, it was those three factors combined that was a big focus at the conference - consumer data, innovation and marketing. That's what we're looking for when we're investing in this sector at the moment.

Touching on another theme that came out of the conference, which has less to do with the inflationary cycle and more to do with capital allocation decisions. We've been reading in the news a lot recently that China's having some issues at the moment. At the conference, we asked management teams what they're thinking about when investing in China. Companies are still committed to the Chinese market over the long term, but some of those incremental investments are being shifted to other emerging markets. For example, L'Oreal, they have a material China business. If we put some conservative assumptions around their growth – if their business only grows at 6% per annum as opposed to double digits, which is what they've been doing in the past, that adds almost an entire Australian business each year, so it's a material market, they're going to stay there, When we think about what they're doing over the medium term for that incremental investment dollar, India is an example that came out a lot at the conference. That's a market where income levels are favourable and consumption is likely to inflect. We're going to see companies invest ahead of that. They're going to put down manufacturing facilities and distribution capabilities to be ahead of that trend.

Through the inflation cycle we have been reducing our consumer staples exposure, has this position changed after attending the conference?

Overall, considering all the insights and learnings that we had, it really reinforced many of the debates that we're having amongst the team and we're comfortable with the level of exposure that we have in the portfolio at the moment. There are still some short-term risks in the sector. Cost inflation is still present in parts of the business. For example, wage inflation is still positive, and that impacts these manufacturers. Also thinking about agricultural commodities, there are pockets of elevated inflation which these companies will have to price for. Cocoa prices seen in the news lately have soared to all-time highs, this means the price of chocolate is going to go up unfortunately.

When we're thinking about the volume growth outlook, that's going to be a key differentiator over the next little while. There are going to be companies that can execute on that winning formula and there are going to be some companies that don't. What we're watching out for is those companies that compete in differentiated categories, some examples of this in the portfolio is pet care, oral care and beauty. We want to position behind those categories and avoid those more commoditised categories, such as mayonnaise, tomato sauce or breakfast cereals. They are the categories we want to avoid exposure because we might start to see higher discounting in those categories to stop the consumer from trading away to a cheaper private label alternative.

Colgate Palmolive was present at the conference and is a recent addition to the global portfolio. What did you take away from the conference that added to your thesis on Colgate Palmolive?

Colgate-Palmolive as a business is best known for their enormous oral care franchise. The Colgate brand operates 20% of the market, which is twice as large as the next brand, so it's a large and incumbent business, high quality, high margin. They also have a really nice India business which is leveraged to any future trends there. Another part of their business is an established home and personal care business which is led by their Palmolive brand. The last piece of their business is a pet care business. They own the brand Hill's Pet Nutrition, which you may have seen at your local pet store or vet.

Colgate serves a really important role in the defensive sleeve of the portfolio. They have incumbent brands in daily use categories and we're not expecting to see consumption decelerate as we move through a cycle. There is an earnings resilience there that we really like. We also like Colgate at this point in time because we believe they are executing really well and investing behind, those three pillars - consumer data, marketing and innovation. Colgate are really starting to hit their stride and we've seen that play out in the oral care category in terms of how they are innovating within the whitening category. They were early to leverage consumer data and understand the consumer and see an emerging beauty trend. They quickly leveraged their research and development teams to reformulate those products and release new product packaging as well. They expanded their toothpaste business and they now have whitening pens and other at home whitening kits which has been engaging the consumer. They've grown market share and that business is margin accretive as well, which we really like. Hopefully that brings together some of the insights we learned at the conference and how this impacts portfolio decisions.

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