Miami Vice

March 2019

I've just returned from the annual Consumer Analyst of New York (CAGNY) conference in Boca Raton, near Miami, where I've heard a wide range of consumer goods companies from the USA and beyond present over the course of the week. Brands continue to be a key idea for us, so this has been a great opportunity to learn more about individual companies, including several of our own holdings, and draw out some overarching themes. Here are the takeaways I found most interesting.

The first – and the reason for my title! – is that packaged snacks are still a fantastic product. It's an unquantifiable observation, but I noticed that many companies presenting referred to themselves as "snack" companies rather than "food" companies. (The announcement of the $15bn Kraft Heinz writedown on the Kraft and Oscar Meyer brands seemed significant.) Globally, the packaged snack market is worth $1.2tn and grew 2.8% in 2018. According to our portfolio company Mondelez's presentation, 75% of global consumers snack on a daily basis. Just to remind you why we like Mondelez – it's the global packaged snacks leader with 21% market share, and the global #1 position in biscuits and candy, and #2 in chocolate and gum. (A quick note regarding biscuits – we would draw a distinction in quality between small packets of branded biscuits e.g. Oreos, and large supermarket packets of undifferentiated biscuits. Some of Mondelez's business is inevitably in the latter but key brands within its biscuit portfolio such as Oreo stand out as uniquely powerful.) Younger consumers snack multiple times per day and sometimes even replace traditional meals with snacks. The consumer dilemma is that they want to snack, but are worried about health – so there's an opportunity to address this with healthier offerings. Many companies have recently acquired these kinds of brands, such as Kellogg's purchase of protein bar brand RxBar or Hershey's acquisition of Pirate's Booty popcorn.

None of this means that "unhealthy" snacks are going away, though. People still have their vices and still want indulgent treats: despite Mondelez's highest volume growth being in the "better for you", the highest dollar growth is in "indulgence" (for Mondelez, that's brands like Cadbury's and Oreos – the world's biggest chocolate and cookie brands). Pepsico, also one of our holdings, emphasised that both its snack and beverage portfolios include "indulgent" and "more nutritious" products, with both categories being equally important. General Mills's super-premium ice cream Haagen-Dazs grew more than 10% last year. And a throwaway comment from Hershey underlined both the demand for confectionary and the decline of printed media – last year the company worked with an unnamed US retailer to reconfigure the shelves next to the tills and give more shelf space to confectionary at the expense of much lower margin and less popular magazines. This led to this retailer's sales of magazines declining 15% and sales of confectionary increased a whopping 40%.

My second observation is that these large consumer companies continue to grapple with the changing competitive landscape. Our portfolio company Unilever illustrated the rate at which markets are fragmenting with the stat that over the last two years, there have been 6000 new brand launches in the top 6 personal care and beauty markets. Most of these brands will of course fail, but some break through and when they do it can be disruptive – e.g. Halo Top low calorie ice cream quickly gained a 6% share of US packaged ice cream. This example is in food rather than personal care, but it illustrates how quickly a challenger brand can build material market share. Johnson & Johnson explicitly attributed these changes to digital disruption – in the past, traditional barriers to entry included expensive supply chains, the need for a media budgets large enough to launch a national campaign, and substantial listing fees (i.e. fees paid to retailers persuading them to stock items), but now small businesses can outsource all of these. In addition, new start-ups can see and exploit small niches and tiny white spaces, thinking like retailers and selling directly to consumers using digital. J&J explained that this means competition is now on two fronts, not only against large multinationals, but also the small start-ups which are driving much of the category growth. Likewise, Unilever emphasised that large companies can't afford to be complacent – it's their job to listen to these brands and figure out what trends they're signalling.

A majority of the companies talked about the need to act more like start-ups, or at least incorporate the most successful elements of start-ups into their business model. Small challenger companies tend to get products to market much quicker than large multinationals – especially using ecommerce – so incumbents are trying to find ways to compress the time between idea and launch, and be prepared to fail or tweak products after launch. Johnson & Johnson tasked a seven person team with the challenge of launching a new teenage skincare line – on a start-up-level budget of $1m. It took just 10 months to launch the C&C brand, working with retailers and teen influencers to accelerate the process. Colgate revealed that their time to launch a new product has fallen from over 18 months to 6-12 months, which they noted is the same timeframe as local companies. Multiple other companies mentioned their own internal “start-up-like” ventures – Mondelez has launched 11 global Innovation Centres, Hershey has an Innovation Incubator, and P&G has already launched five new brands via its P&G Ventures. And Danone’s CEO described the need for large packaged food companies to “self-disrupt”, but also pointed out that the cost of launching a brand has never been as low as it is today. Start-ups benefit from this environment – but there’s no reason why large multinationals shouldn’t as well.

L’Oréal’s presentation reminded me why we are enthusiastic about the beauty industry as a whole, why we continue to be happy holders of Shiseido and why we were so cheered to see Unilever’s recent spate of premium beauty acquisitions. Globally the beauty market is growing at a tremendous clip – 5.5% last year, the fastest rate in two decades – and far from being disintermediated, big beauty brands have in fact been boosted by digital. L’Oréal’s eight biggest brands together grew 8.4%, which, again, is the best growth in two decades. Within these eight, the four “billionaire brands” are all growing at more than 10%. The CEO confirmed Johnson & Johnson’s observation that barriers to entry are indeed now lower and that it is easier for people to start small beauty brands, so the number of them in the market is likely to remain higher than before – but it is still difficult for these brands to scale, and there is a rapid churn. And if the big brand in question is a top tier brand with a credible digital strategy, digital can be a phenomenal powering force – in a fragmented world consumers still seek out trusted names, and algorithms, blogs, reviews and influencers can increase big brand exposure as never before. Nestlé agreed that big brands are far from dead: their 34 “billionaire” brands (i.e. with yearly revenues of more than 1bn Swiss francs) are actually growing faster than their other portfolio brands.

It was also encouraging to see two concrete examples of big brand beauty products which satisfy the current consumer desire for products which offer an experience and are personalised, two qualities which many have argued are best addressed by smaller and more “nimble” brands. The first was J&J’s personalised face mask, which takes information from a photograph of the face and uses 3D printing technology from J&J’s medical device segment to produce personalised masks. The second was L’Oréal brand Lancôme’s tailor-made foundation offering, which takes a picture of the customer’s skin and makes a custom-made foundation in front of you in a process lasting around 20 minutes. The machine is small, attractive and easy to ship to stores; the product itself is $88, which is in the same ballpark as other high end foundations. In both cases, these products will allow J&J and L’Oréal to build a valuable database of information about their customers’ skin.

Emerging markets were another big theme during the week. L’Oréal reminded me that the future global demographics for beauty look excellent. It’s estimated that 2.4bn people around the world will join the middle and upper classes by 2030, and that in the same time period this demographic’s spending will triple in Asia, double in Latin America, Africa and Middle East and increase by one and a half times in Western Europe. In emerging markets beauty consumption per capita is much lower than in developed regions – five times lower in Asia and the Middle East than North America, Western Europe and Japan, and ten times lower in Africa. Certainly good news for Shiseido, with its 26% of revenues from China. Food and beverage companies see equally attractive opportunities in emerging markets – the expansion into developing markets, particularly Nigeria, was the first item on Kellogg’s agenda and a key pillar of their turnaround strategy.

Coca-Cola is not exactly a new entrant into emerging markets, but I liked the CEO’s illustration of the huge opportunity that lies ahead for beverage manufacturers: only 25% of soft drink consumption in developing markets (i.e. 80% of the world) is commercial beverages. Increasing that percentage by just 1% to 26% would create an extra $45bn in retail value. Very encouraging for the beverage segment of our portfolio holding Pepsico, which itself pointed out that outside the US there are huge salty snack opportunities. For example, in Turkey the branded salty snack consumption is less than 1kg per capita per year – compare that to the US or UK where the figure is a rather horrifying more than 10kg.

With 59% of Unilever’s revenues coming from emerging markets, this is a key theme and they certainly delivered in terms of exciting stats. CFO Grame Pitkethly shared the extraordinary IMF estimates that by 2021 there will be an extra 300m people –

that's another USA – living in emerging markets. 800m more consumers will live in cities, giving Unilever more bathrooms and kitchens to clean. 400m more households will reach the middle income tier and 200m more women will enter the workforce. We think the fact that Unilever has had a presence in India since 1888 is a really important differentiator and I was amazed to hear that 9 of 10 Indian households use a Unilever product every day. Mondelez also benefits from its 70 year presence in India through Cadbury, which today has a 40% share of the Indian chocolate market. Mondelez itself has 37% of total revenues from emerging markets.

It was also cheering to hear Mr Pitkethly separate volume and value growth. Unilever's emerging market volume growth has increased for the third year running, which is a key metric as pricing can theoretically be eroded – but volume growth fundamentally means that quite simply, more people are buying Unilever products. And unlike companies such as Kellogg's which are building out their emerging market businesses at the (hopefully temporary) expense of margins, Unilever's long presence in markets such as India mean that its businesses are established and sales here are margin accretive.

Finally, a note on cannabis. Don't worry, I'm not about to announce a new investment – this is far too speculative a prospect for our taste! But I do think it's worth noting that for the first time a cannabis company, Canopy Growth, was amongst the line-up at CAGNY. This Canadian company has a market cap of $14bn and alcoholic beverage company Constellation Brands, also presenting this week, has just taken a $4bn stake. And what made me sit up and listen was that the theme of Canopy's presentation was "cannabis as a disruptive ingredient". Who knows if it will indeed go on to disrupt the markets cited – pain relief, animal health, sleep, anxiety, alcoholic beverages and sports drinks? (For what it's worth, Constellation said that they took a stake in the belief that cannabis and alcohol have different consumption occasions, and that cannabis users are actually more likely to drink alcohol as well.) As I said, the chances of LT making an investment in this nascent industry are slim to none. But we have to be alert when we hear the word "disruption" in conjunction with the industries in which we invest, even if that's likely to be far off in the future.

Madeline Wright, Deputy Portfolio Manager

Lindsell Train Ltd

Source: Lindsell Train & Bloomberg

Risk Warning

This document is provided for information purposes only and is intended solely for use by professional investors and advisors. Specifically, it is not intended for, and is not suitable for, those who would be categorised as Retail Clients, and it should not be relied upon by private investors.

Past performance is not a guide or guarantee to future performance. Investments are subject to risks and may also be affected by exchange rate variations. The investment value and income may go down as well as up. Investors may not get back the amount they originally invested.

The MSCI information may only be used for your internal use, may not be reproduced or redisseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.msci.com).

"FTSE ®" is a trademark jointly owned by the London Stock Exchange Plc and The Financial Times Limited and is used by FTSE under licence. "All Share" is a trademark of FTSE. FTSE does not sponsor, endorse or promote the content of this communication.

Opinions expressed whether in general or both on the performance of individual securities or funds and in a wider economic context represents the view of the fund manager at the time of preparation and may be subject to change without notice. It should not be interpreted as giving investment advice or an investment recommendation. No part of this document may be copied, reproduced or distributed to any other person without prior express written permission from Lindsell Train Limited.

LTL 000-218-1 11 March 2019

Lindsell Train Limited
66 Buckingham Gate
London
SW1E 6AU
UNITED KINGDOM

Tel. 020 7808 1210
Fax. 020 7808 1229
www.LindsellTrain.comInfo@lindselltrain.com

Please refer to Lindsell Train's Glossary of Investment terms here.