THE FMCG GLOBAL 50 2018

Action stations

The FMCG giants are taking action to respond to industry challenges

OC&C Strategy consultants

uncommon sense

The Global 50 report is our annual snapshot of the world's 50 largest FMCG businesses. Now in its 16th year, it is the go-to source for the statistics and big themes that shape the sector.

Industry giants such as Nestlé, Procter & Gamble and Unilever are ranked on their FMCG revenues then evaluated on broader performance metrics. Information is taken from the latest annual report of each business and turnover is stated in US dollars. Growth rates are quoted in the local currency in which each company reports.

Last year's Insight report was titled 'Tied-up' as companies were hamstrung by geopolitical and industry uncertainty. This year finds the Global 50 very much liberated, engaging in record levels of M&A and restoring overall revenue growth. Yet lurking behind the headlines is the industry gremlin of stagnant organic sales growth. The most successful Global 50 firms have defied this by focusing on premium product and nurturing emerging markets. At the same time, they are futureproofing themselves with some surprising acquisitions in tech and non-core areas – think a meat producer investing in vegetarian sausages – and investment in sustainable packaging. Meanwhile, Global 50 profit margins continued to increase steadily, aided by a swathe of zero-based budgeting (ZBB). However, whilst ZBB may be aiding margins, the formula to tackle slow organic growth remains elusive.

> This year finds the Global 50 engaging in record levels of M&A and restoring overall revenue growth

A record year for M&A

2017 marks the reawakening of the Global 50 following a year of M&A inertia, with deal numbers rocketing to a 15 year high of 60. FMCG companies shook off uncertainty fuelled by the rise of populist leaders in Europe and the US and stepped up to industry-wide challenges.

The resulting spree propelled headline revenue growth from 0.5% in 2016 to a striking 5.7% in 2017, and resulted in a 190% year-on-year value increase to USD145bn.

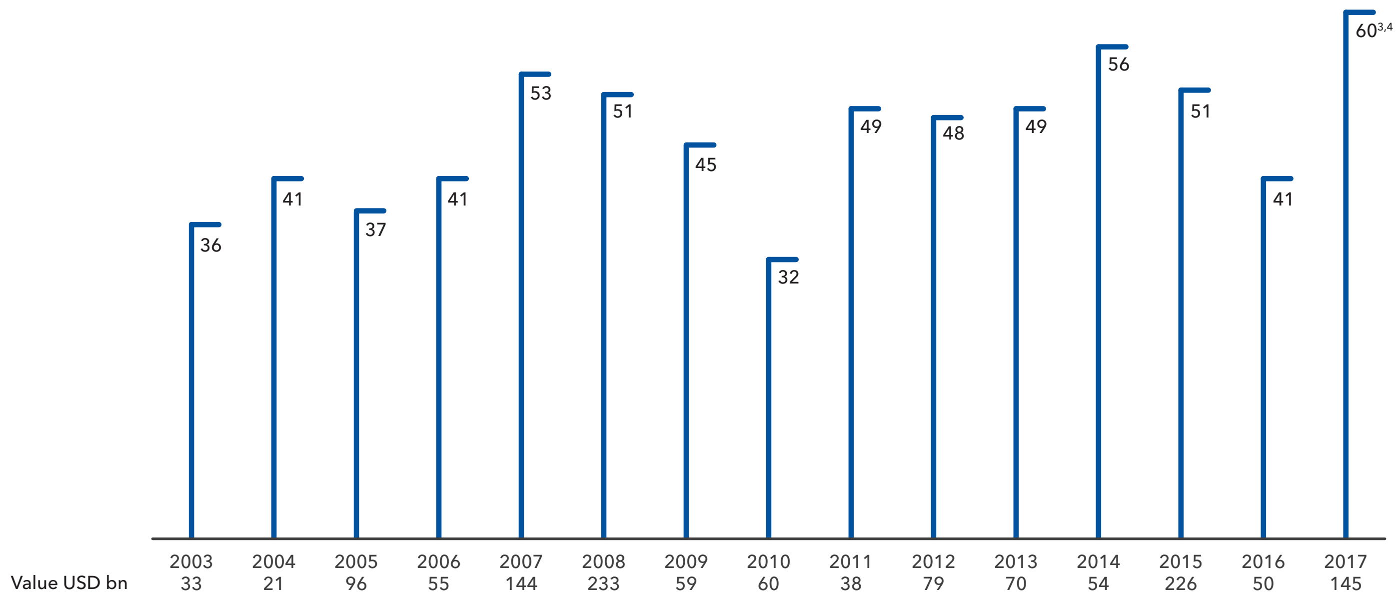
Leading the pack was British American Tobacco with a takeover of Reynolds American that contributed to USD c.61bn of the total. Its sector-mate, Japan Tobacco splurged on six deals (compared to zero previously) to attain growth in new and emerging geographies.

This proved to be a broader theme for Global 50 M&A, with this year's deals focusing on growth as well as consolidation. Entering new/emerging geographies and product areas accounted for 73% of deal volume compared to 62% in 2016. We saw, for example, Nestlé acquire an Egypt based coffee distributor, and L'Oréal buy a Mexico based cosmetics company. Meanwhile, divestments were driven by strategic realignment, such as SCA's split of its forest products and personal care business into two separately listed companies.

While Food & Drink in particular enthusiastically jettisoned peripheral businesses, some of the Global 50 actively sought to acquire new capabilities beyond their current core with acquisitions in logistics and technology. We explore this micro-trend on Page 12.

THE NUMBER OF DEALS FOR THE GLOBAL 50 JUMPED TO A 15-YEAR HIGH IN 2017

Number of deals involving the Global 50[1], 2003-17[2]



1. Undisclosed value deals are not considered
2. Dates refer to the deal announcement date. Deals that have been announced in 2017 are considered for analysis.
3. 65 transactions in total by Global 50 players (41 acquisitions and 24 divestments), but 5 of these included a Global 50 player on both sides of the deal.
4. Excluded 4 deals with non-FMCG purposes or deals within the same group of companies, including Johnson & Johnson's acquisition of biopharmaceutical company, Actelion Pharmaceuticals Ltd, LVMH's acquisition of Christian Dior Couture S.A., Henkel (Adhesive Technologies)'s acquisition of Darex Packaging Technologies, merger between three AB InBev indirect Nigerian subsidiaries (International Breweries, Intafact Beverages and Pabod Breweries).

Source: Mergermarket, Trade press, OC&C analysis

A year of contrasts

ORGANIC GROWTH WAS FLAT...

Total year-on-year sales growth of 5.7% may have us reaching for the Champagne, but the figure masks the challenge of organic growth which remained stagnant at 2.6%.

Though this is a slight improvement on prior years' reducing growth, volume only accounted for 0.4% pts of organic growth as the Global 50 sparred with the likes of craft gin makers, fleet footed private labels, and a slowdown of developed markets.

A notable outlier was Heineken (that can aptly celebrate with a drink) which outperformed the market by focusing on premium segments and strengthening its foothold in emerging geographies to deliver another year of strong organic growth.

The majority of the Global 50, however, relied on price/mix to boost revenue growth. This was achieved either by exterior forces, for example Arla Food benefiting from dairy price inflation, or initiatives such as Coca-Cola's optimisation of packaging size.

Relying too heavily on price/mix to prop up organic growth is a risky strategy, and with organic volume gains well below an annual global population growth of c.1.1%, it is clear that the Global 50 are failing to capture an increasing consumer base.

Unless, like Heineken, the Global 50 learn from their smaller and more nimble competitors, they will continue to lose market share to smaller firms.

...BUT PROFITABILITY IMPROVED

Whilst organic growth continued to underperform, the Global 50 continued a five year trend of gross margin uplift with a 0.7% pt increase.

The Global 50 also achieved their first net margin improvement in three years, also of 0.7% pt.
The improvement – a potential sign of zero-based budgeting taking hold – is largely driven by freezing (or trimming) operating, R&D and marketing costs whilst driving up gross margins. Whether this provides the right foundations to restore growth in the long term, however, remains to be seen.

HEALTHY PRODUCT, HEALTHY MARGINS

The war on sugar is not necessarily bad news for Coca-Cola. In the US it has addressed consumer health concerns by selling mini cans. US sales of smaller formats grew nearly 10% in the fourth quarter of 2016, while overall organic revenue increased 6%, a trend that is expected to continue. In a double win, smaller pack sizes bring in a higher price per ml.

THE PRICE INCREASE OF COCA-COLA WAS DUE TO PORTFOLIO MIX SHIFT TOWARDS SMALLER FORMAT AND HEALTHIER PRODUCTS

Smaller format

Volume
12 fl. oz.
Price
$1.15
Unit price
$0.10/fl.oz

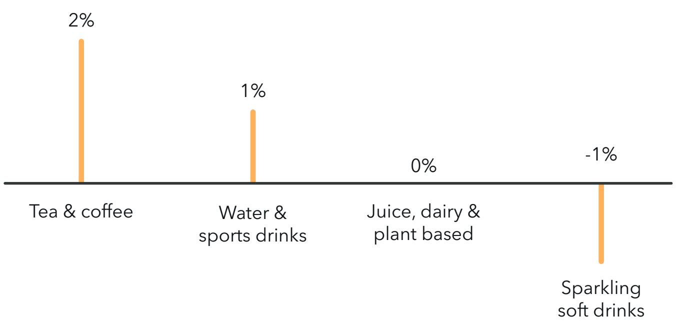
Volume
7.5 fl. oz.
Price
$0.9
Unit price
$0.12/fl. oz.

Prevalence of healther products

Tea brand named "Gold Peak" with unit price of $0.18 per fl. oz.

Sports drinks under the name of "Vitaminwater" with unit price of $0.16 per fl. oz.

COCA-COLA GLOBAL UNIT VOLUME GROWTH, 2017



The winning and losing sectors

THE WINNING AND LOSING SECTORS

While Beer & Spirits and Tobacco knuckled down to the business of M&A and organic expansion, other sectors, such as Food & Drink, lacked active consolidators and focussed on divestment rather than growth.

Beer & Spirits was 2017's star performer boasting 4.6% organic revenue growth and a 1.8% pt uplift in profitability. This was partly due to healthy M&A, but also a strategy to foster premium brands and enter new markets. Tobacco also performed well for these reasons and its continued ability to extract price from a semi-captive market.

In comparison, total sales growth in Food & Drink, which accounted for 17 out of 24 divestments on the list, languished at 0.8%, as it failed to fend off small challenger companies specialising in niche or premium product. Household & Personal Care was the biggest loser underperforming both in organic growth (1.5%) and profitability (-0.2%).

ZERO-BASED BUDGETING – THE JURY IS OUT

Four of the top five performing Global 50 companies for profit margin improvement are zero-based budgeting (ZBB) adopters, but is the approach impacting growth?

Most Global 50 companies that engaged in ZBB have improved profit margins since 2015, thanks in part to savings in SG&A. However, these cuts – particularly in sales and marketing – have led to an underperformance in organic revenue growth compared to non-adopters.

One exception is ZBB poster child AB InBev that has been successful in both growth and profitability. It improved COGS through economies of scale, allowing it to return to increased investment in sales and marketing after the first few years of tightening.

However, other Global 50 ZBB adopters have continued to see organic growth challenges, including Kraft Heinz that is backed by ZBB cheerleader 3G. This could be due to over aggressive cost cutting that may now need to be scaled back, or it may simply be a factor of the underlying brands and the categories in which they play.

With a mixed bag of results, it remains to be seen whether in future years ZBB will be regarded as a fad or an industry saviour.

SECTORS DIFFER IN THEIR FINANCIAL PERFORMANCE[1]

		Global 50	Foods & Drinks	Household & Personal Care	Beer & Spirits	Tobacco	Diversified Companies
YOY change	Total revenue growth[2]	5.7%	0.8%	2.9%	**22.2%**	**12.3%**	6.2%
	Organic revenue growth[3]	2.6%	2.2%	1.5%	4.6%	2.9%	3.1%
% of Rev. (ppt change)	Gross margin growth[2]	0.7%	0.0%	**-0.8%**	4.7%	1.0%	0.2%
	Profit margin growth[3]	0.7%	0.5%	**-0.2%**	1.8%	0.5%	0.6%
% of Rev. (ppt change)	Total operating cost growth	0.0%	-0.4%	-0.7%	**2.9%**	**0.4%**	-0.4%
	Marketing expense growth	-0.1%	-0.7%	0.0%	-1.2%	**0.4%**	-0.1%
	R&D expense growth	0.0%	0.0%	**0.1%**	0.0%	**0.1%**	-0.1%
	Contribution to Global 50 Grocery sales	(100%)	(49.0%)	(17.4%)	(12.8%)	(9.4%)	(11.4%)
	#Companies	50	23	10	7	5	5

1. The figures correspond to an average of the players in the sector
2. Based on 2017 grocery turnover (excise duty excluded) in local currency
3. Organic growth based on 20 companies which reported the data in ARs

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

The Global 50 Champions

The 2017 Champions list was dominated by beverage businesses (both soft and alcoholic drinks) showing this sector has adapted more swiftly to changing consumer trends than its peers. However, the similarity ends there: each champion was selected for its unique industry–beating strategies.

Heineken continues to refresh the parts of P&L other companies cannot reach, particularly organic growth. It has done this by identifying, and consistently acting on, two clear growth opportunities – premium beer and emerging markets. Examples of its strategic excellence include investment in production capacity in Cambodia, where the beer industry grew by 11% last year, compared to no growth Europe.

Shiseido is the only non-drinks player in our Champions list. Like Heineken, the Japanese firm delivered good growth from premium propositions. It was also lauded for strong tactics in geographic expansion, such as building relationships with key e-commerce operators in China.

The majority of the Global 50 relied on price/mix to boost revenue growth

RANK	COMPANY	RATIONALE	COMMENTS
15	HEINEKEN	Continued improvement in organic volume growth	Heineken's organic volume growth increased year by year from 1.9% to 2.9% from 2014-2017
47	SHISEIDO	Strong organic growth in 2017	Shiseido's organic growth reached 11%, fuelled by investment in premium brands and success in China
8	Coca-Cola	Ability to increase price/mix through own efforts	Coca-Cola price/mix increase in 2017 was 3%, above industry average, helped by mini can formats
5	AB InBev	Increasing profit margins (with zero-based budgeting) while still maintaining strong organic growth	Leading organic revenue growth in the beer sector at c.5% per year since 2012 Profit margins improved by 7ppt since 2008
23	DIAGEO	Success in investing for growth	Good growth and margin performance as sustained investment in premium brands pays off

2017 RANKING OF THE GLOBAL 50

RANK	CHANGE VS 2016	COMPANY	COUNTRY	GROCERY SALES IN MILLION USD IN 2017[1]	GROCERY SALES % CHANGE IN LOCAL CURRENCY SALES 17 VS 16[2]
1	-	Nestlé	Switzerland	$91,187	0%
2	-	Procter & Gamble	US	$64,553	0%
3	-	PepsiCo	US	$63,525	1%
4	-	Unilever	UK/Netherlands	$60,531	2%
5	1	Ab InBev	Belgium	$56,444	24%
6	-1	JBS	Brazil	$49,626	-1%
7	1	Tyson Foods	US	$38,260	4%
8	-1	Coca-Cola Company	US	$35,410	-15%
9	-	L'Oréal	France	$29,326	4%
10	-	Philip Morris International	US	$28,748	8%
11	3	Danone	France	$27,808	12%
12	-1	Kraft Heinz	US	$26,232	-1%
13	5	British American Tobacco	UK	$26,116	38%
14	-2	Mondelez	US	$25,896	0%
15	-2	Heineken Holding	Netherlands	$24,665	5%
16	-1	Archer Daniels Midland	US	$22,530	2%
17	-	WH Group	China	$21,303	5%
18	1	Altria Group	US	$19,407	1%
19	-3	Suntory	Japan	$19,235	3%
20	3	Asahi Breweries	Japan	$18,176	23%
21	-1	Japan Tobacco	Japan	$18,076	-1%
22	-1	General Mills	US	$15,620	-6%
23	4	Diageo	UK	$15,508	15%
24	-	Colgate Palmolive	US	$15,454	2%
25	-	Kimberly Clark	US	$15,010	0%

1. Sales excludes excise payments
2. Percentage change exclude excise duty payment

RANK	CHANGE 2017/16		COMPANY	COUNTRY	GROCERY SALES IN MILLION USD IN 2017[1]	GROCERY SALES % CHANGE IN LOCAL CURRENCY SALES 17 VS 16[2]
26	▲	+4	Reckitt Benckiser	UK	$14,816	16%
27	▲	+2	Grupo Bimbo	Mexico	$14,134	6%
28	▲	+3	Johnson & Johnson	US	$13,602	2%
29	▼	-7	Kirin Beweries	Japan	$13,525	0%
30	▲	+10	LVMH	France	$11,995	9%
31	▲	+7	Henkel	Germany	$11,854	9%
32	▲	+5	Estée Lauder Companies	US	$11,757	5%
33	▲	+1	Kellogg Company	US	$11,674	-1%
34	▲	+33	Molson Coors Brewing Company	US	$11,003	125%
35	▲	+6	Royal FrieslandCampina	Netherlands	$10,969	10%
36	◆	-	Kao	Japan	$10,841	0%
37	▼	-2	Nippon Meat Packers	Japan	$10,719	-3%
38	▲	+4	Brasil Foods	Brazil	$10,487	-1%
39	▲	+4	Pernod Ricard	France	$10,153	4%
40	▼	-1	Imperial Tobacco	UK	$10,063	6%
41	▲	+5	Arla Foods	Denmark	$9,956	7%
42	▼	-9	Essity	Sweden	$9,662	10%
43	▲	+5	Bunge Limited	Bermuda	$9,593	13%
44	▲	+1	Carlsberg	Denmark	$9,361	-1%
45	▼	-1	Hormel Foods	US	$9,168	-4%
46	▲	+1	Yamazaki Baking	Japan	$8,756	1%
47	▲	+12	Shiseido	Japan	$8,692	17%
48	▲	+1	Tingyi	China	$8,450	6%
49	▲	+1	Campbell	US	$7,890	-1%
50	▲	+6	Danish Crown	Denmark	$7,887	5%

Future champions are doing this...

INVESTING IN INNOVATION

It is not just the number, but the type of deals, that makes 2017 stand out. Mega-mergers aside, Global 50 companies have stepped up efforts to acquire businesses beyond their current core that directly address the needs of the modern consumer.

As a result, we have meat producer Tyson Foods investing in Beyond Meat, a company that makes plant-based burgers and sausages – a smart hedge in a world of Veganuary and Meat Free Mondays. The top 10 companies have also invested in D2C start-ups as they seek closer ties to consumers. Unilever no doubt collects more data on men's grooming habits from its 2016 acquisition of tech-led Dollar Shave Club, than from traditional market research.

The race to better know the digital customer has led to investment in non-FMCG companies such as online content platforms and marketing and analytics start-ups. Unilever, for example, invested in Celtra, a creative management platform for digital advertising. This gives it a foothold in next-gen technology at a time when marketing budgets are under pressure and the big integrated marketing agency model of WPP and its peers is being questioned. Likewise, Coca-Cola's investment in logistic technology platform Bringg helps it compete in a retail environment where Amazon has rewritten the rules. Large FMCG companies (that have not already) will need to adopt this more holistic approach to investing, to ensure they do not become anachronisms in our digital future.

VENTURING OUT

The power and influence enjoyed by Big FMCG since the 1950s has long since been usurped by Big Tech – the GAFAs of this world. The Global 50 has woken up to this, with 9 out of the Top 10 involved in venture funding to target technology-driven businesses. Funds and incubators typically have a good level of autonomy to foster a 'start-up' feel and approach to risk. This allows space for unfettered innovation from which the parent company can ultimately benefit.

SHIFTING TO SUSTAINABLE PACKAGING

While most areas of business development are driven by market research, an invigorated focus on sustainable packaging was arguably caused by a sea turtle. When viewers in over 30 developed countries watched the creature struggle to free itself from a tangle of plastic on the BBC's nature documentary Blue Planet II, there was international outcry.

Though the anti-plastic movement is not new, there was a 23% year-on-year increase in search terms on the subject in 2017, with younger generations in particular demanding more environmentally friendly packaging. Retailers and regulators reacted, with South Africa aiming to ban un-recyclable shopping bags in the Western Cape, and UK supermarket Tesco pledging to ban all non-recyclable plastic by 2019.

The Global 50 followed suit, with many exploiting the trend to seek new growth opportunities among the more environmentally minded Millennial and Generation Z consumers, such as PepsiCo's Drinkfinity and LVMH's Dior Life.

Further up the supply chain, the Global 50 invested in partnerships to develop more sustainable packaging. In 2017, Nestlé joined forces with Danone and the chemicals start-up Origin Materials with the aim of creating a 100% bio-based plastic made from waste such as sawdust or old cardboard.

A SUSTAINABLE BUSINESS STRATEGY?

The real impact of developing sustainable packaging will take time to materialise. While consumers say they will pay a price premium for eco-friendly product, will that offset, for example, the fact that some bio-based materials are estimated to cost 3-5 times as much as their fossil-based counterparts?

FMCG will also be under the spotlight to deliver genuine environmental impact: there is no use in reducing visible packaging if its benefits are offset by a rubbish heap of damaged shop floor product or further incongruence further up the value chain.

With so much in the balance, it is vital that FMCG companies take the opportunity to holistically evaluate their supply chains to make sure they are getting sustainability right. Regulatory and consumer forces may mean FMCG companies soon will not have a choice, and those that are prepared will have a distinct advantage.

PEPSICO DRINKFINITY

In 2018, PepsiCo launched a new, ecommerce-only brand, Drinkfinity, in the US and Europe. This healthy squash-like drink comes in the form of recyclable plastic pods that are 'popped' into a special reusable bottle. The product neatly satisfies the three Millennial tick boxes of experience, health, and environment.

LVMH'S DIOR LIFE

Launched in 2017, the skincare line is made of non-toxic natural ingredients and packaged in lightweight glass and natural materials. It is aimed at younger, environmentally conscious consumers.

GROUPING THE INNOVATION INVESTMENTS BY STRATEGY SHOWS SOME CLEAR THEMES INCLUDING A FOCUS ON DIGITAL CAPABILITIES, CHANNEL STRATEGY, HEALTH AND THE ENVIRONMENT

INVESTING IN TECH-LED INNOVATION				
	1	Good for consumers & good for the environment: innovations in product technology	Tyson, Beyond Meat	Plant-based alternatives to meat products
			P&G, Native	Natural, aluminium-free deodorant (also D2C)
	2	Packaging for the future: innovations in sustainable packaging technology	Nestlé, Danone, NaturAll Bottle Alliance	Alliance with aim of creating bio-based PET bottles
	3	Closer ties to the consumer: D2C and subscription services	Unilever, Sun Basket	Healthy meal delivery subscription
			Coca-Cola, lepur	D2C premium Greek yogurt
	4	Knowing your consumer better: leveraging digital, marketing and analytics	ABInBev, octi	Social media video content creation using AI
			Unilever, celtra	Digital advertising platform
	5	Improving business operations: tech solutions to improve supply chain and back-office	Coca-Cola, Bringg	Delivery logistics platform

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