THE FMCG GLOBAL 50 2019

Reaping the rewards

Recent actions drive improving organic growth and margins

OC&C Strategy consultants

uncommon sense

2018 a quietly triumphant year...

In 2017 the world's biggest FMCG companies grabbed the headlines with a series of dazzling mega-deals, with BAT's US$ c.61bn takeover of Reynolds taking centre stage. There were no such blockbuster acquisitions in 2018, but it was a strong year for the Global 50 as prior M&A activity began to bear fruit.

Over the last few years, the Global 50 has been snapping up companies that cater to new and fast growing consumer trends, such as the shift towards wellness, and consumers' seemingly never ending love affair with coffee. These acquisitions are beginning to pay off, resulting in a return to organic volume growth and record profit margins.

Buoyed by this, deal activity in 2018 was driven by the continued desire to shift portfolios towards fast growth areas and strengthen existing positions. In absence of mega deals, M&A value fell 48% from 2017 to US$75bn, though the number of deals remained relatively high (55 versus 60 in 2017).

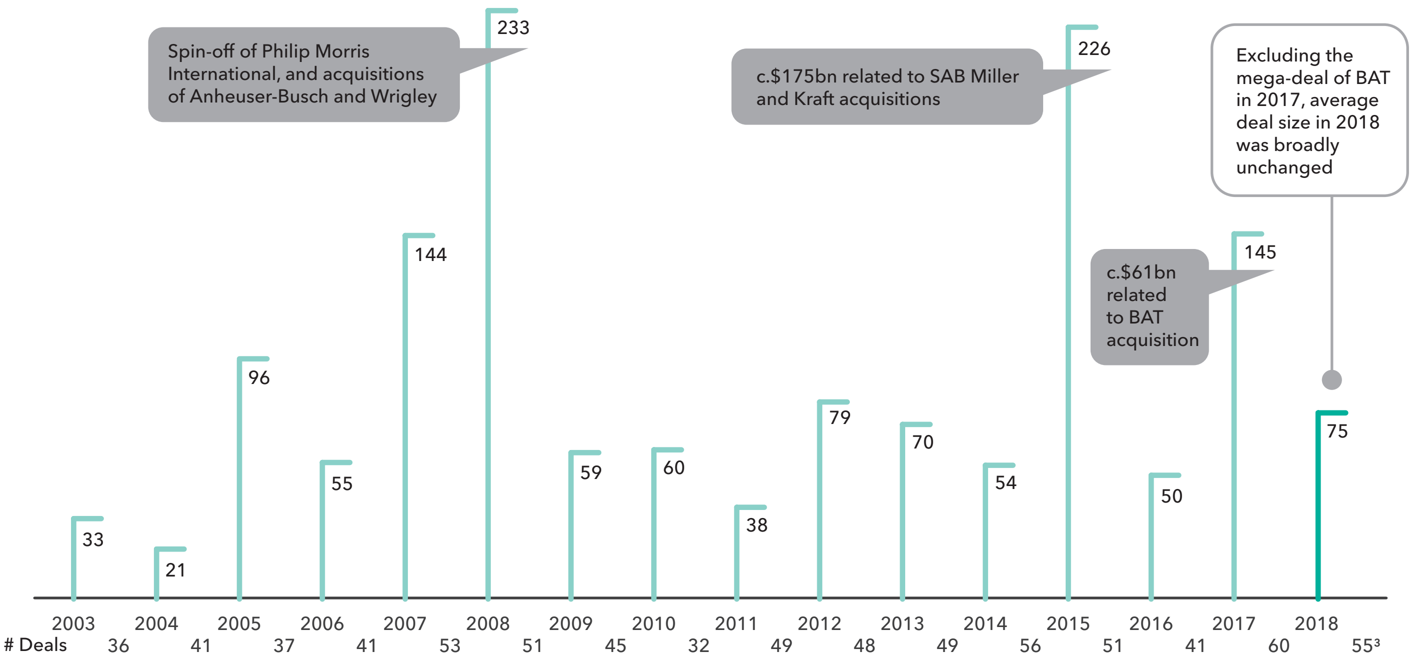
There was little movement in the Global 50 leaderboard, as 'heads down' replaced the moving and shaking that characterised 2017. The usual suspects - Nestlé, Procter & Gamble and PepsiCo - retained their podium positions, and only five companies moved more than three places. Chinese spirits producer Kweichow Moutai was the only new entrant, knocking out Brazil Foods.

Kweichow Moutai's addition to the list highlights a long term trend, the rise of Asia-based companies in the Global 50. In the ten years to 2018, the number of Chinese and Japanese companies featuring in the leaderboard increased from 7 to 13, accounting for 15% of the Global 50's total sales.

Zero Based Budgeting (ZBB) continued to yield profit for its Global 50 adopters, but at the ongoing expense of organic sales growth. Meanwhile, the downfall of high profile ZBB proponent Kraft Heinz raised questions as to whether the budgeting method will really deliver all that it promised.

DEAL VALUE FELL BUT THE VOLUME OF DEALS REMAINED HIGH

Value of deals involving the Global 50[1], 2003-18[2] (US$bn)



1. Undisclosed value deals are not considered
2. Dates refer to the deal announcement date. Deals that have been announced in 2018 are considered for analysis
3. Excluded deals that are executed by non-FMCG unit of the Global 50 for non-FMCG purposes

Source: Mergermarket, Trade reports

HOW WE COMPILE THE GLOBAL 50

The Global 50 report is our annual snapshot of the world's 50 largest FMCG businesses. Now in its 17th year, it is the industry authority on the statistics and big themes that drive 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.

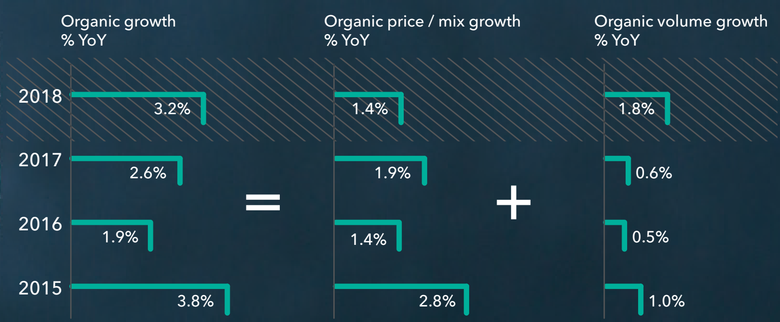
A double whammy

2018 saw the Global 50 return to organic volume growth whilst posting record profitability.

IN CONTRAST TO PREVIOUS YEARS, VOLUME HAS BECOME THE MAIN DRIVER OF ORGANIC REVENUE GROWTH IN 2018

Organic growth breakdown[1] 2015-2018

All companies reporting organic growth[2]



1. Excludes acquisitions/divestments and exchange rate effects
2. 20 of the 50 companies report available time series data and breakdown of organic growth

Source: Annual reports; 10K

A TRIUMPHANT YEAR FOR ORGANIC VOLUME GROWTH

Last year we warned that the Global 50 was relying too heavily on price/mix to prop up organic growth, as smaller more nimble competitors grabbed market share. In 2018 the big brand owners reversed this: organic growth increased by 3.2% year on year, with 1.8.% coming from volume and 1.4% from price/mix.

This was largely due two factors. The first is the fruition of previous investments into fast growth areas. The second is that the big brands finally caught up with (dare we say learnt from) their more digitally sophisticated, smaller competitors.

1.) Prior investment into fast growth categories pays off

Beer and spirits company Diageo has enjoyed continued organic volume growth due to the success of its 'Reserve' stable of brands. Labels such as Tanqueray, Bulleit and Don Julio continue to fly off the (bar) shelves thanks to growing consumer demand for luxury alcoholic drinks. It continues to build on this: in 2017, Diageo purchased Casamigos, the tequila company co-founded by Hollywood actor George Clooney, to give it a foothold in the premium tequila market.

2.) Learning from the upstarts

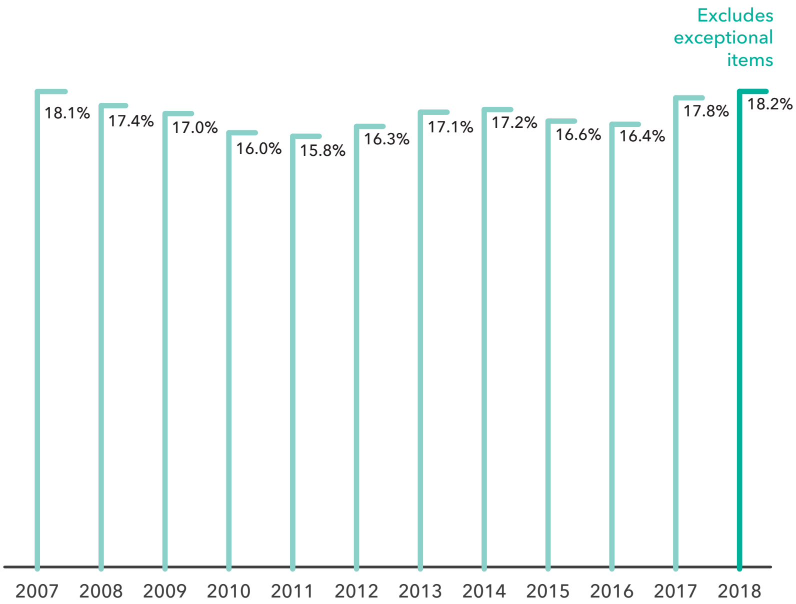
Legacy brands have suddenly found themselves competing with digitally savvy challengers that use a smart blend of online sales channels and sophisticated marketing to win younger customers. In the cosmetics world, Estée Lauder is now head to head with direct-to-consumer brands such as Glossier, and Kylie Cosmetics - a predominately online brand fronted by super influencer Kylie Jenner. To combat this in 2018, Estée Lauder adopted an omni-channel approach supported by content driven marketing. It more than doubled its social media posts year on year, focusing on highly shareable, video led, storytelling.

AN ALL-TIME HIGH FOR PROFITS

The profitability of the Global 50 continued to improve to 18.2%, its highest level since the Global 50 began in 2002. This was driven by both by the phenomenon of 'premiumisation' as well as efficient management of operating costs.

GLOBAL 50 PROFIT MARGINS INCREASED 0.4% POINTS TO REACH A RECORD HIGH

Average profit margins[1] of FMCG Global 50, in %



1. Denotes adjusted EBIT / revenue, adjusted EBIT excludes the impact of exceptional items that are one-off and do not occur on a regular basis, e.g. gain on sales of property and substantial non-cash impairment
Source: Annual reports

1.) Premium profitability

2018's record profitability was partly driven by continued consumer demand for all things premium. Coffee is a good example of this, where a cup of instant at breakfast time has been usurped by a single origin espresso from a coffee pod machine (Clooney again!). The upside of this for F&B producers is that they are able to generate a significantly higher margin for capsules than traditional ground or freeze-dried coffee.

2.) Efficient gains

In 2018 the Global 50 continued to improve cost efficiency, with total operating costs down 0.2% pts compared to 2017. Tobacco outperformed all other sectors with profit margin growth of 1.7% pts. This was helped by a 0.5% pts reduction in operating costs, as synergies from previous M&A consolidation were realised. Beer & Spirits and Foods & Drinks recorded growth in net margin as both sectors also managed to decrease operating costs – Unilever, Coca-Cola, Mondelez and AB Inbev all managed to reduce operating costs as a percentage of sales through their ZBB efficiency programmes.

2018 M&A activity – coffee and care

Although 2018 had no deals to match BAT's show stealing acquisition of Reynolds in 2017, M&A activity continued at a steady pace. The number of deals remained more or less the same year-on-year (55 versus 60 in 2017), and average deal size remained unchanged at US$1.4bn – excluding BAT's 2017 mega-deal effect.

What did change however, was the motivation driving the deals. Whereas 2017 was about consolidation and entering new geographic markets, the primary aim of deals in 2018 was to accelerate the shift into new higher growth product areas. Tobacco firm Altria Group, for example, acquired Juul to diversify into vaping. Meanwhile, Nestlé purchased Starbucks' consumer packaged goods business to strengthen its position in the coffee market.

COFFEE AND CARE DRIVE M&A

Four of the top ten deals in 2018 were related to the fast growth categories of coffee and consumer health.

Jumping beans

The global coffee market has grown at 5% between 2015 and 2018. This is largely driven by 'premiumisation', where producers are able to command higher margins for more luxury products.

Coffee has not one, but three product areas driving premiumisation, as consumers increasingly care about the cachet of their cup.

The first is coffee pods (see 'Premium profitability' above). The second is high quality 'craft' coffee, marketed with an emphasis on production techniques and flavour. Finally, there are cold brews and ready to drink 'coffee in a can' type beverages. These, when coupled with premium-look packaging, can be sold at caffeine fuelled price points.

It is no wonder big brands are battling to capture this market, with players such as JAB Holding Company and Nestlé both on acquisition sprees. In 2018, Coca-Cola entered the fray with the acquisition of Costa Coffee. This will allow it to diversify away from the sugary carbonated beverages that are losing popularity among young consumers. At the same time it can leverage its expertise in the drinks sector to launch cold brew and ready to drink coffee product lines.

Healthy acquisitions

Over the past few years, traditional pharma companies have been offloading their consumer health products to FMCG in order to concentrate on their core drug pipelines. The move makes sense for FMCG companies that already have the brand building and route-to-market capabilities to succeed with such products. Moreover, it gives them a chance to expand their presence in the growing wellness market.

2018 saw two major health acquisitions. Unilever bought GSK Consumer Healthcare's nutrition and digestive portfolio, giving it access to brands such as Horlicks, Tums and Eno antacids. Meanwhile, P&G bought Merck's Consumer Health Unit, allowing it to improve its technical capabilities in consumer health, and sell brands such as Seven Seas, Vivera and Bion3 across its established distribution network.

Static energy

The Global 50 leaderboard stayed broadly similar to 2017 with no significant change to companies and their rankings. Indeed, there was only one drop out and subsequent new entry – it was 'goodbye' to Brazil Foods due to the deprecation of the Brazilian real, and 'hello' to Chinese spirits producer Kweichow Moutai, following strong sales of its star product, baijiu, an ancient grain based liquor.

Just five companies had changes of more than three places. Notably BAT moved up six places, as the newly acquired Reynolds American was incorporated, while Chinese food producers, Yili and Mengniu, moved up by 9 and 4 spaces respectively through organic growth. Molson Coors Brewing suffered the biggest drop of 5 places as Americans shied away from its beers.

2018's star players

That is not to say the Global 50 has been resting: we have identified five companies that have outperformed their peers in terms of sales or profit (or both). All five are united in that they have identified fast growing consumer markets and acted to serve them. Coca-Cola and Yili won the health conscious crowds, Estée Lauder wooed Millennials online, and Kweichow Moutai quenched the Chinese thirst for premium spirits.

> It was 'goodbye' to Brazil Foods due to the deprecation of the Brazilian real, and 'hello' to Chinese spirits producer Kweichow Moutai

2018 STAR PLAYERS

RANKING	COMPANY	RATIONALE	COMMENTS
9	Coca-Cola	Strong organic sales and profit growth	Organic sales growth of 5% and 6.6% increase in profit margin which is strongest improvement among Global 50
29	ESTĒE LAUDER COMPANIES	Strong sales growth	Sales growth of 16% which is one of the top 5 in the Global 50
34	伊利	Strong sales growth	Sales growth of 18%, above local and global competitors
46	MOUTAI	Strong sales growth while increasing profit margins	Top sales growth of 25% in Global 50 with profitability improvement of 4%
47	SHISEIDO	Continued improvement in sales growth	Shiseido's sales grew further by 9% in 2018 after 17% increase in 2017

CASE STUDY

Star company

Coca-Cola

A flavour for growth

Coca-Cola achieved organic sales growth of 5% in 2018, and a peer beating 6.6% increase in profit margin, as its drive to become a 'total beverage' company gathered pace.

Coca-Cola identified a problem: young, increasingly health conscious North American consumers were shunning drinks made with artificial sweeteners in favour of exotically flavoured waters and smoothies. Its marketing department responded in full force with the launch of four new diet coke flavours in January 2018. Ginger Lime, Feisty Cherry, Zesty Blood Orange and Twisted Mango debuted in slimmed down cans with a new design. Its annual report described the rebrand as 'successful'.

SMARTWATER = SMART FINANCIALS

Coca-Cola drove organic price growth by launching more premium products. An example of this is the expansion of its premium water brand SmartWater. Two new products, SmartWater Antioxidant and SmartWater Alkaline, cleverly leverage two 'wellness' buzz words that appeal to today's health conscious consumers.

CASE STUDY

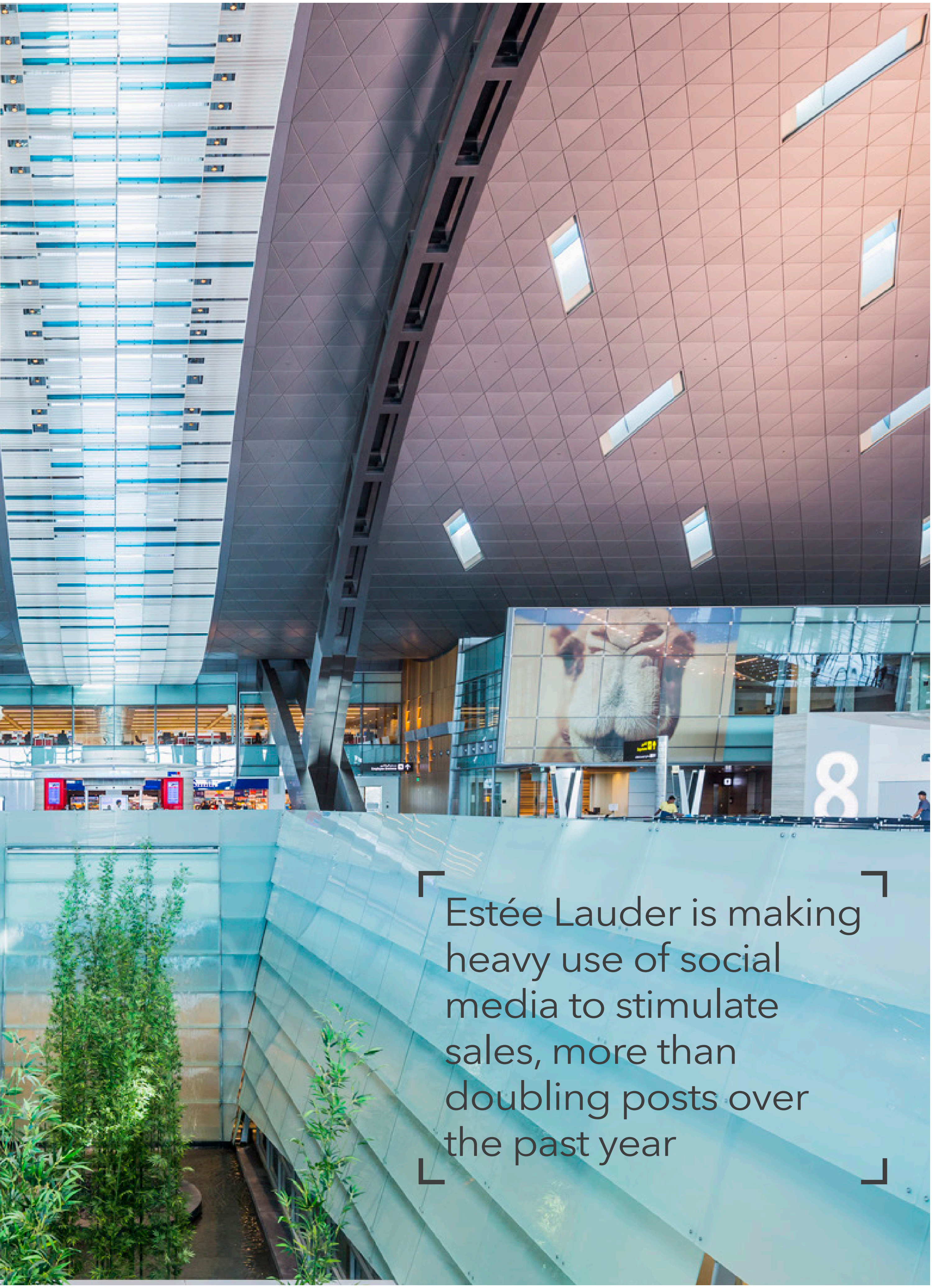
Star company

ESTĒE LAUDER COMPANIES

Retail gets a makeover

The 'stores vs ecommerce' battle is old news.

The modern beauty buying journey is a combination of several retail channels. Estée Lauder has embraced this by reimagining the physical store as a brand building vehicle rather than a pure point of sale. In June 2018, for example, it opened a pop-up travel retail store in Qatar airport offering experiences such as mini facials, bespoke gift wrapping and its digital iMatch tool to find a customer's perfect foundation shade. The resulting brand experience complements rather than competes with ecommerce, the cosmetic giant's fastest growing retail channel. It is also making heavy use of social media to stimulate sales, more than doubling posts over the past year (see 'Learning from the upstarts' above).



Estée Lauder is making heavy use of social media to stimulate sales, more than doubling posts over the past year

Eastern Promise: the rise of China

Though there were no big risers and fallers in the 2018 Global 50 list, the addition of Chinese spirits firm Kweichow Moutai highlighted a long term trend: the rise of Japanese and Chinese companies.

Over the last decade, the number of Asia-based companies in the Global 50 increased from 7 to 13. In this period, Chinese companies increased from zero to five, and outperformed their Japanese counterparts in terms of sales growth.

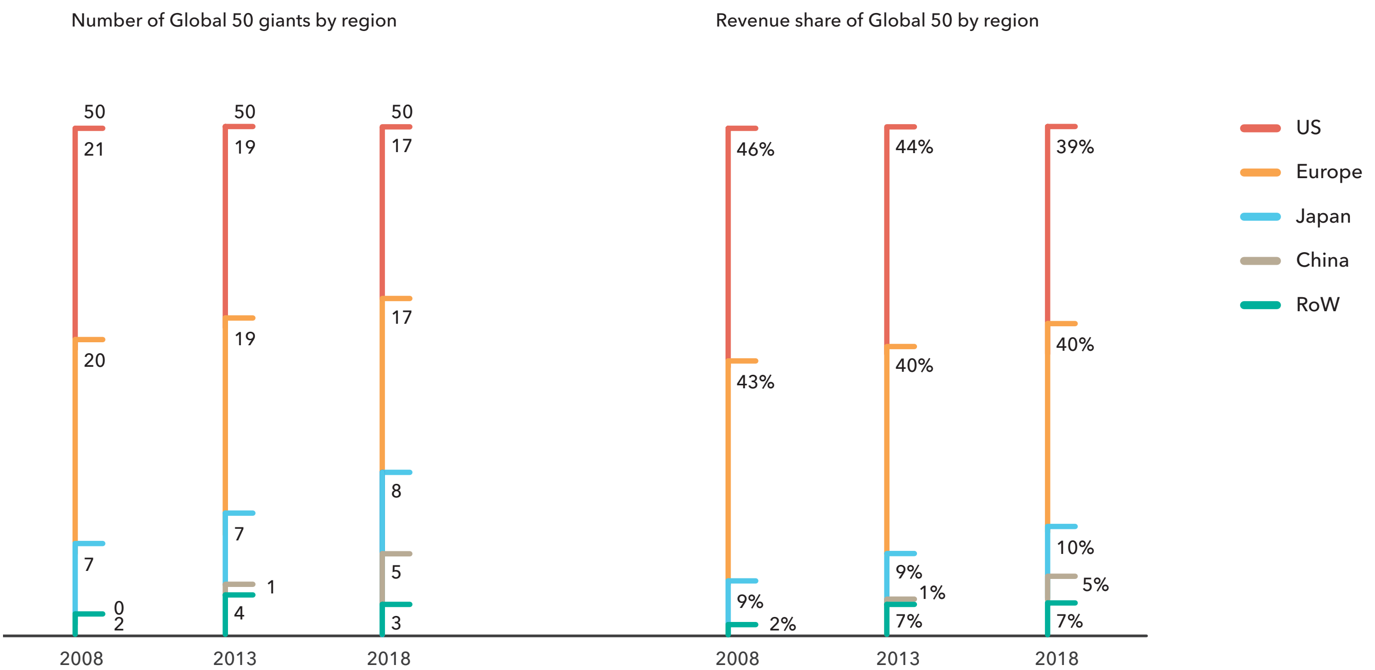
This continued success may seem counterintuitive to the headlines telling us that the Chinese economy is slowing. However, this is not the case for the Chinese food and drink sector, which is growing at nearly double the rate of its global peers. This is due to three reasons. The first is an emerging middle class in China's tier three and tier four cities. To date, these locations have been overlooked by Western brands, leaving them ripe for the picking by local players. Secondly, both Japanese and Chinese companies have invested heavily in product innovation and expanding their geographical reach and sales channels. The third element driving their growth, is expansion into emerging markets.

These three factors ensure that there will no doubt be more Chinese entrants to the Global 50 in coming years. However, their success is not a shoo-in: the average profitability of Asian Global 50 companies in 2018 was 14%, significantly below the 18% global average. As domestic competition heats up, there is also increasing downward pressure on margins, with the majority of Asian giants registering negative margin growth in 2018.

> The Chinese food and drink sector is growing at nearly double the rate of its global peers

ASIAN-BASED GIANTS HAVE BECOME EVER MORE IMPORTANT WITH THE NUMBER OF FIRMS NEARLY DOUBLING, REPRESENTING 15% OF TOTAL GLOBAL 50 SALES

Geographic evolution of the Global 50



Source: OC&C Global 50 reports in 2009 and 2014; Annual reports

CASE STUDY

Star company

Milking a growth market

One of our star companies, Chinese dairy company Yili, grew sales by a staggering 17.8% in 2018 compared to the previous year.

Since 2013, it has released over 200 new products in order to capture growth markets, such as the increasingly health conscious young Chinese consumer. In 2017, for example, it launched new plant protein soya milk drinks complete with Millennial-friendly packaging. In echoes of Coca-Cola's North American strategy, it also invested in a natural water project to gain a foothold in the bottle watered segment.

In addition to innovation, Yili has also increased sales by increasing its geographical reach. Since 2005, it has focused on selling to lower tier cities, and increased its points-of-sale in villages from 110K in 2015, to 530K in 2017.

The above two strategies are backed up by the highest advertising spend in the industry (c.12%), ensuring that the Yili brand is front of mind for both city influencers and village labourers alike.

CASE STUDY

Star company

Baijiu, the billion dollar beverage

Ask any Westerner to name a premium spirit and you can bet that baijiu does not make the list. Yet it is one of the most popular tipples in the world.

The ancient Chinese spirit is made from varying combinations of sorghum, wheat, rice, and corn, and packs a punch at 50-60+% proof.

It is also the reason that Chinese alcohol producer Kweichow Moutai entered the Global 50 in 2018. Upping the price of its star baijiu product resulted in the company achieving annual sales growth of 25% – the highest in the entire Global 50. This was achieved by a marketing push to position the brand as the go-to premium drink for festive and business events.

Like Yili, Moutai cemented its market leading position by expanding its sales channels. Its network of small shops, for example, increased from c.2000+ in 2015, to c.3000+ in 2017. It also partnered with online giants to increase sales.

Kweichow Moutai achieved annual sales growth of 25% – the highest in the entire Global 50

Is ZBB falling out of fashion?

In 2015, there was a gold rush towards Zero Based Budgeting, a method of cost planning from the 1960s, revived in recent years by activist FMCG investor 3G.

While its comeback was initially 'all the rage', a marked reduction in mentions of ZBB in 2018 annual reports suggests it is falling out of fashion again.

This could be due to recent issues experienced by ZBB adopter Kraft Heinz. At the start of 2019, it wrote down US$15.4bn in addition to disclosing that the SEC was investigating its procurement accounting practices. Combined with stagnating EBITDA and sluggish organic growth, this has put the spotlight on its use of ZBB.

Industry commentators, from analysts to the media, questioned whether it was to blame for the companies woes. Stinging comments calling the company's implementation of ZBB 'a black eye' and a 'truly awful idea' did little to boost the method's reputation.

Despite this, most of the Global 50 that have engaged in ZBB have seen an improvement in profit margins since adoption. However, as we mentioned last year, ZBB companies seem to underperform in organic revenue growth compared to non-adopters. This suggests that ZBB, while improving efficiency, is certainly not helping companies to address their growth challenges.

With ZBB still in its infancy, it is still impossible to tell if it will deliver its promised returns: is Kraft Heinz just a blip, or a warning of things to come?

This suggests that ZBB, while improving efficiency, is certainly not helping companies to address their growth challenges

2018 RANKING OF THE GLOBAL 50

RANK	CHANGE 2018/17		COMPANY	COUNTRY	GROCERY SALES IN MILLION US$ IN 2018[1]	GROCERY SALES % CHANGE IN LOCAL CURRENCY SALES '18 VS '17[2]
1	◆	-	Nestlé AG	Switzerland	$93,400	2.1%
2	◆	-	Procter & Gamble	US	$66,335	2.8%
3	◆	-	PepsiCo	US	$64,661	1.8%
4	◆	-	Unilever	UK/Netherlands	$60,120	-5.1%
5	◆	-	AB InBev	Belgium	$54,619	-3.2%
6	◆	-	JBS	Brazil	$49,044	12.4%
7	◆	-	Tyson Foods	US	$40,052	4.7%
8	▲	+6	British American Tobacco P.L.C	UK	$32,656	25.2%
9	▼	-1	Coca-Cola Company	US	$31,856	-10.0%
10	◆	-	L'Oréal	France	$31,766	3.5%
11	▼	-2	Philip Morris International	US	$29,625	3.1%
12	▼	-1	Danone	France	$29,070	-0.6%
13	▲	+2	Heineken Holding	Netherlands	$26,499	4.0%
14	▼	-2	Kraft Heinz	US	$26,259	0.7%
15	▼	-2	Mondelez	US	$25,938	0.2%
16	◆	-	Archer Daniels Midland	US	$24,831	10.9%
17	◆	-	WH Group	China	$21,283	-0.1%
18	▲	+1	Suntory	Japan	$20,383	4.3%
19	▼	-1	Altria Group	US	$19,513	0.5%
20	▲	+2	Japan Tobacco	Japan	$18,974	3.3%
21	◆	-	Asahi Breweries	Japan	$18,765	1.6%
22	▼	-2	Kimberly Clark	US	$18,434	0.7%
23	▲	+3	Reckitt Benckiser	UK	$16,796	10.0%
24	▲	+1	Diageo	UK	$16,148	0.9%
25	▼	-2	General Mills	US	$15,740	0.8%

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

2018 RANKING OF THE GLOBAL 50

RANK	CHANGE 2017/16	COMPANY	COUNTRY	GROCERY SALES IN MILLION US$ IN 2018[1]	GROCERY SALES % CHANGE IN LOCAL CURRENCY SALES '18 VS '17[2]
26	-2	Colgate Palmolive	US	$15,544	0.6%
27	+1	Grupo Bimbo	Mexico	$14,993	7.8%
28	-1	Johnson & Johnson	US	$13,853	1.8%
29	+1	Estée Lauder Companies	US	$13,616	15.8%
30	-1	Essity	Sweden	$13,614	8.4%
31	+1	LVMH	France	$13,249	5.6%
32	-1	Kellogg Company	US	$12,312	6.0%
33	-	Henkel	Germany	$12,228	-1.4%
34	+9	Yili Group	China	$11,891	17.8%
35	+1	Kirin Breweries	Japan	$11,748	5.7%
36	-2	Royal Friesland Campania	Netherlands	$11,563	-4.1%
37	+1	Nippon Meat Packers	Japan	$11,494	5.6%
38	-1	Kao	Japan	$10,824	-1.7%
39	+2	Bunge Limited	Bermuda	$10,820	12.8%
40	-5	Molson Coors Brewing Company	US	$10,770	-2.1%
41	-2	Pernod Ricard SA	France	$10,598	-0.3%
42	+4	Mengniu Dairy	China	$10,420	14.7%
43	-3	Imperial Tobacco	UK	$10,347	-0.8%
44	-2	Arla Foods A.M.B.A	Denmark	$10,301	-1.1%
45	-	Carlsberg	Denmark	$9,891	3.0%
46	+12	Kweichow Moutai	China	$9,813	25.4%
47	+2	Shiseido	Japan	$9,657	9.2%
48	-4	Hormel Foods	US	$9,546	4.1%
49	+1	Tingyi	China	$9,064	3.0%
50	-2	Yamazaki Baking	Japan	$8,973	0.9%

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