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Consumer Goods

INDUSTRY OVERVIEW



Consumer Goods Introduction

UNDERSTANDING THE BASICS

The consumer goods industry is the core of any economic population. It represents the material goods that people from all walks of life need or want, resulting in corporations built to address their demand.

This industry can be separated into two sub-sectors:

1. Staple Goods

- This sector consists of companies that provide items that are necessary for basic living such as food or soap. Known to many as the defensive sector, these companies stand resilient to business cycles and do not conform to the state of the economy, as they are routine, first-priority purchases.

2. Discretionary Goods

- Comparably inverse to the staple goods, this sector represents the companies that provide the non-essential goods to consumers, desired when purchased with excess income. Highly influenced by business cycles and the state of the economy, this sector is dependent on favorable consumer confidence.



Staple Goods Overview

SUB-SECTOR ANALYSIS

The three main product categories of consumer staples are all highly competitive subsectors due to a vast variety of substitute products meeting basic needs. As a result, creating a sustainable competitive advantage is difficult.

Key Drivers of this sub-sector

- Cost of production
- Cost reduction of a company's operational expenses
- Differentiate their product in order to grow demand and justify the premium

Market Sensitivity

- The consumer staple sector creates very low-price elasticity of demand. As a result, consumers are very sensitive to market prices and are attracted to products that offer the lowest cost for the highest return in value.
- The sensitivity based on macro-economic factors is relatively low for this sector. As a result, it is much more accurate to assess the sector's sensitivity to consumer preferences and trends.



Discretionary Goods Overview

SUB-SECTOR ANALYSIS

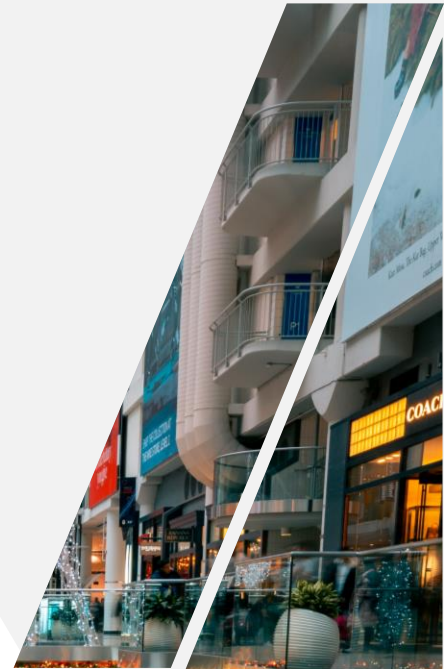
The consumer discretionary sector can be split into five major groups: automobiles and components, consumer durables and apparel, consumer services, and media and retail. Consequently, this highly diverse sector has industries with various parts in the product life cycle and competitive outlooks.

Key Drivers of firms in this industry

- State of the economy & interest rates
- Consumer confidence
- Brand image & customer loyalty
- Costs of production

Market Sensitivity

- The business cycle for the consumer discretionary sector is cyclical. It's highly sensitive to the business cycle as consumers consider these items as normal goods. As a result, when their disposable income increases so does the correlation with the ability to purchase these discretionary goods.
- This sector is known for having very high capital expenditures around inventory and optimizing inventory response times and logistics to cater to the dynamic market.

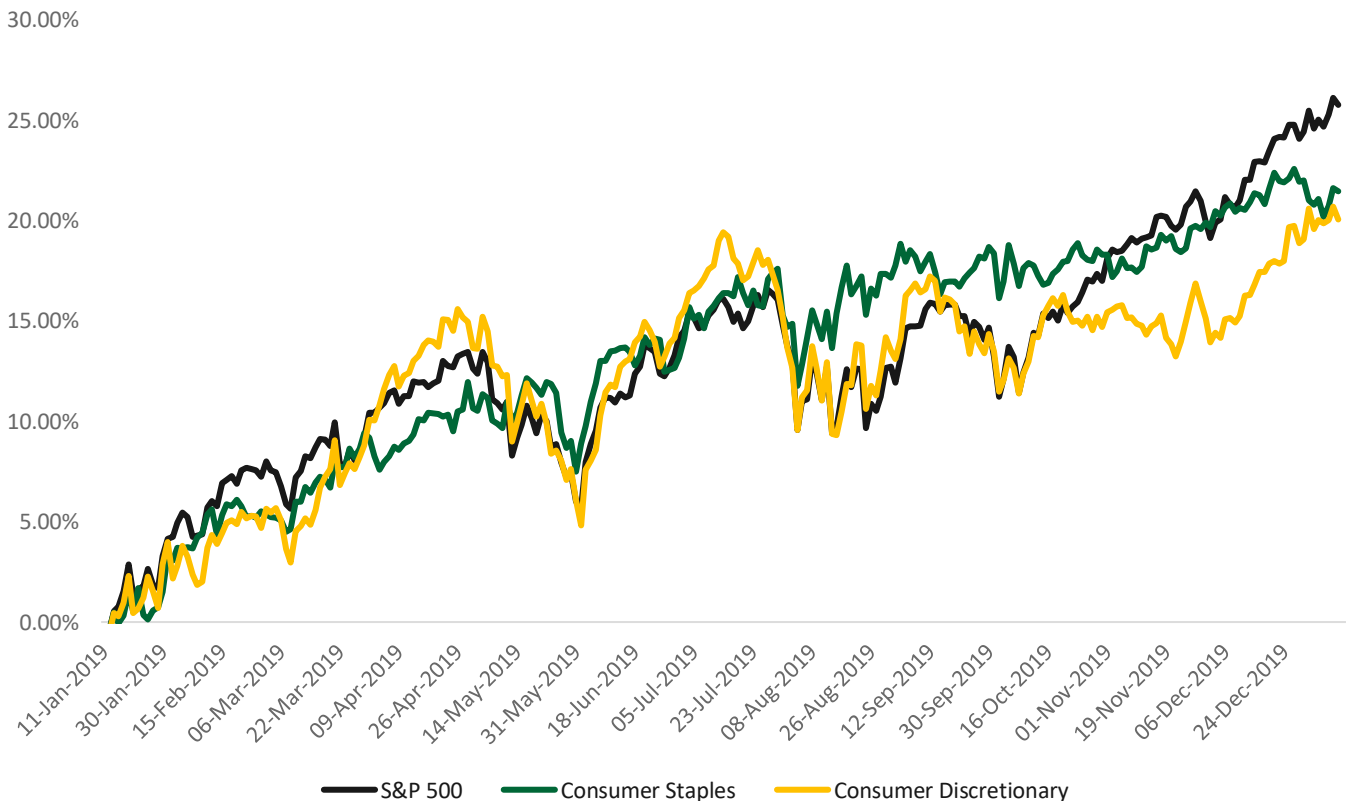


Consumer Goods Valuation

HIGH-LEVEL ANALYSIS

- Historically, North American markets have been thriving from the past decade of bullish growth.
- This growth has allowed the discretionary consumer goods industry to flourish, while staples goods has been lagging.
- Currently, it seems as though the growth is not wavering.
- In August of 2019 10-year T-bills inverted several times, a recognized red flag for an impending recession.
- While not a sure sign, these inversions preceded the past seven recessions.
- When accounting for the volatility caused by trade wars, and the current geopolitical tensions, the future is radically uncertain.

Figure 1: Consumer Staple Index, Consumer Discretionary Index, and S&P Index



Discretionary Goods Valuation

HIGH-LEVEL ANALYSIS

- With the current US and Canadian economy in its late cycle we can expect to see both economic and corporate activity at its peaks.
- Inflation rates at the moment are relatively low and the general labour force has seen the quickest rise in wage growth in the last decade. Moreover, tighter lending standards have been implemented for credit with wider credit spreads.
- With the late cycle and tight credit environment we can expect to see a gradual decrease in consumer discretionary spending as the market continues to correct towards a more defensive stance.
- Average EV/ EBITA of 15.73
- Average P/E of 29.38

Figure 2: EV/EBITDA Ratios of Discretionary Goods Firms

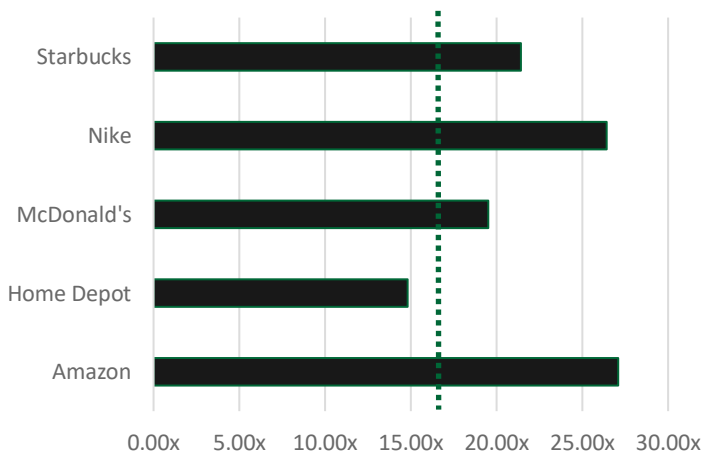
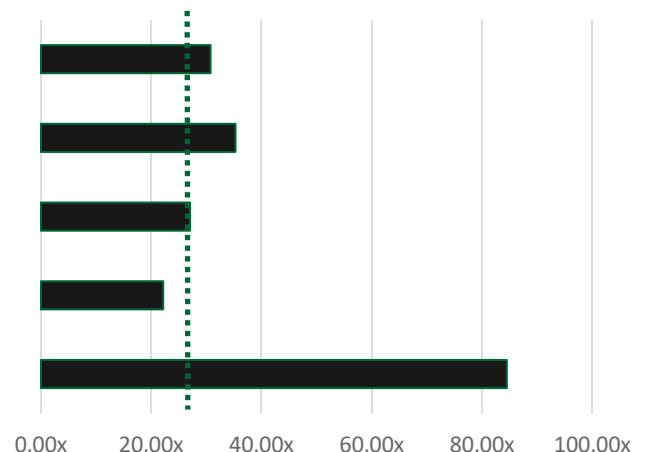


Figure 3: P/E Ratios of Discretionary Goods Firms



Staple Goods Valuation

HIGH-LEVEL ANALYSIS

- In general, the consumer staples sector seems to be at peak relative performance when the economy is in its late cycle, entering any recession or political uncertainty.
- However, uncertainty of continued growth has made the consumer staple sector a safe haven in today's economic and politically unstable climate
- The sector begins to grow and increase in the transition from a bullish to bearish market. Thus, it is safe to say that in 2020 the industry is poised for positive outlook and growth.
- Average EV/ EBITA of 16.62
- Average P/E of 29.29

Figure 4: EV/EBITDA Ratios of Staple Goods Firms

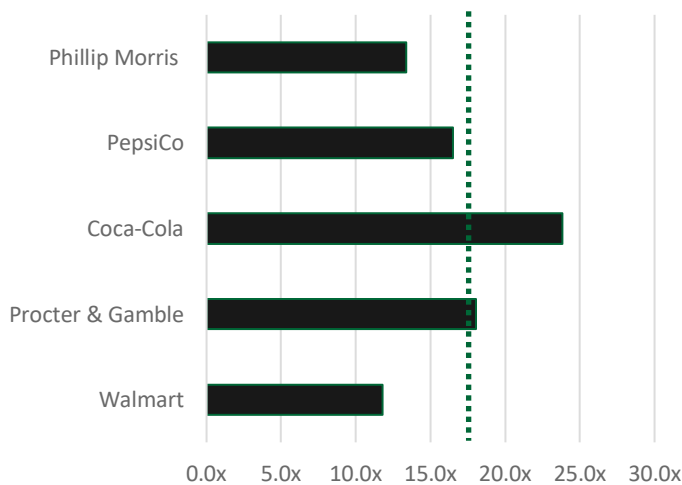
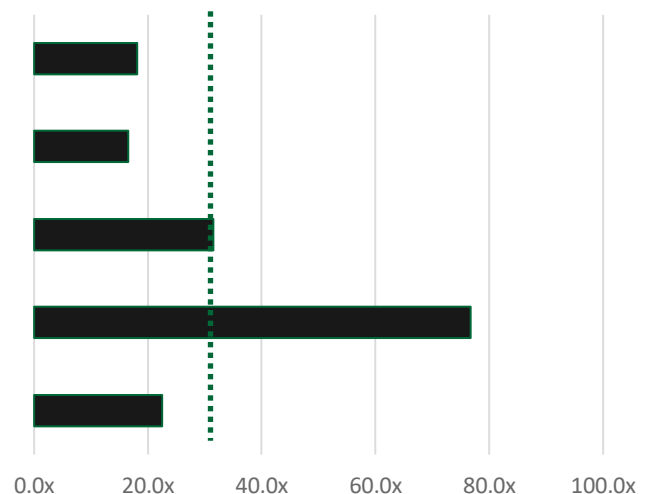


Figure 5: P/E Ratios of Staple Goods Firms



Industry Trends

CONSUMER STAPLES

1. Local, healthier food offerings

- Consumers are becoming increasingly health-conscious and are seeking healthier alternatives to their traditional produce and food and beverage choices.
- Ex. Coca-Cola and PepsiCo have been expanding their product line to offer non-carbonated beverages that are more calorie conscious.

2. Eco-friendly products

- 'Green' alternatives to traditional consumer staples products have been increasing in recent times as the general population is becoming more environmentally aware. Sustainability is becoming one of the most important issues in the minds of business leaders.
- Ex. Nestle has a carbon productivity score of 85%; the highest rating in the entire sector. The company has shifted its primary use of energy to 50% biofuels.

3. Plant based food alternatives

- One of the most recent trends is the introduction of plant-based meat alternatives. With time and technological advancement, comparatively affordable alternatives may be the future of the meat industry.



Industry Trends

CONSUMER DISCRETIONARY

1. Electric vehicles

- The electric car market has been extremely popular and companies such as Tesla are beginning to make a dramatic industry impact. This trend is influencing traditional car manufacturers to introduce electric vehicles in their product lineups.

2. Online retailers

- Online stores are beginning to take the place of traditional brick and mortar stores. Companies who traditionally only offered a physical location have been investing in online mediums.

3. Traditional retails

- Another mature industry with high competition and new entrants constantly entering the marketplace. Technology is continuing to constantly change this industry and companies are adapting to stay on top of trends in business.

4. Hyper-personalization and experiential retailers

- These are the top two trends in this industry. Big data, AI, and VR are all being used to create an individual-focused shopping experience new ways to interact with retail products.



Short-term Consumer Goods

FUTURE OUTLOOK

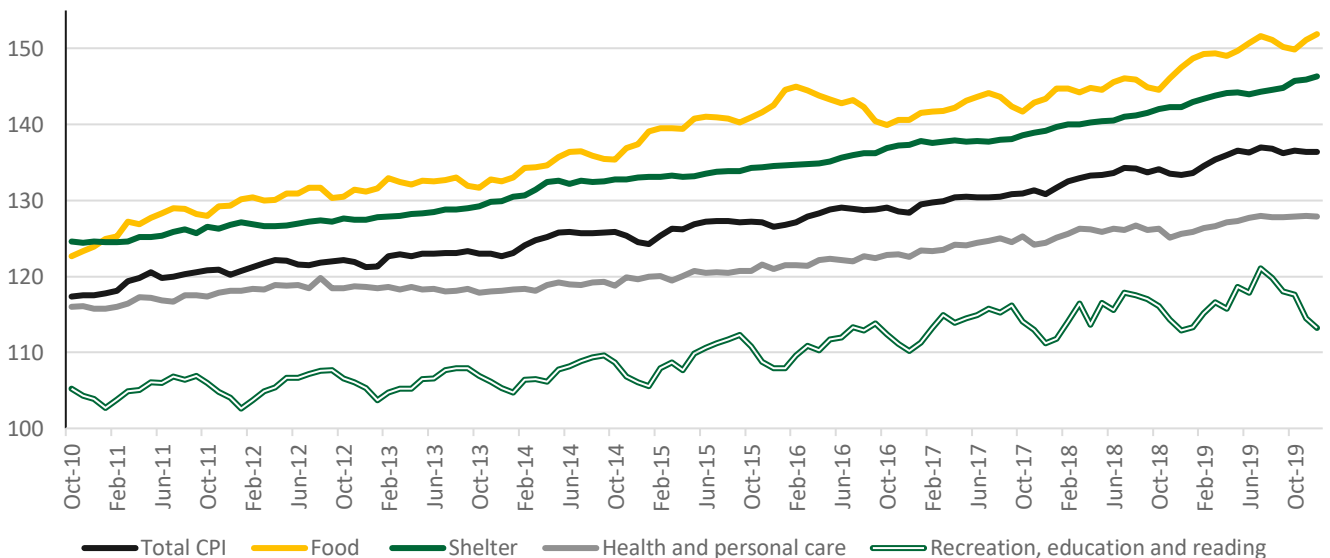
2020 Expectations

Moving into 2020, falling consumer confidence, continuing trade disputes between America and China, and global economic slowdown are likely to impact the consumer goods market. The Conference Board, along with many analysts, forecast US GDP growth to be 0.2% below 2019's rate of 2.3%.

Impact on Consumer Goods Market

Although the general consumer goods market will take a hit if economic slowdown continues to materialize, the consumer staples industry is expected to display the least pronounced effect, given its innate defensive characteristics. This is because consumers cannot simply cut back on staple goods as they can with non-essential, discretionary goods. As a result, the consumer staples sector has historically outperformed the broader market during times of economic slowdown. If economic contraction manifests, expect consumer goods to realize a moderate hit, with the consumer staples firms seeing the least burden as consumers spend less on discretionary goods and more on necessary staple goods.

Figure 6: Monthly Canadian Consumer Price Index Values



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